WAR AND INDIAN ECONOMY

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WAR AND INDIAN ECONOMY

BY

V. K. R. V. RAO,

University Professor of Economics, Delhi.

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TO

The memory of My Mother

PREFACE

The following pages contain an attempt to study the effects of the war on Indian Economy and the manner in which the problems arising therefrom have been sought to be tackled by Government. The utility of the study has been qualified by the difficulties of insufficient data, inevitable in war-time. Nevertheless, the author believes that enough material is available not only to analyse the effects of war on Indian Economy but also to suggest in broad outline the kind of economic policy which is needed for the successful handling of India's economic problems. An attempt has also been made briefly to indicate the fundamentals of a post-war economic policy for this country. It may be added that the statistical material used in this study has all been compiled from official publications.

Though the book was practically ready by the end of April, certain difficulties prevented the author from immediately sending it to the press. The intervening period has witnessed certain important developments in Government's war-time economic policy. Though this has not revealed the need for any change either in the author's analysis or suggestions on the problems of Indian war economy, he has thought it fit to add an appendix briefly reviewing recent developments in Government's economic policy.

An explanation is perhaps due for my frequent reference to the political factor during the course of this study. I am aware that there are some people who hold the view that economic studies should be 'pure' in the sense that they should contain neither mention nor analysis of even relevant political data. I agree that academic economic studies should be free from any political or party bias; but to dissociate economic problems from their political setting, especially when the problems in question relate to war economy, will be, in my opinion, to neglect a most vital factor in the situation and would, to that extent, constitute an unacademic departure from pure analysis. In fact, the nature and effectiveness of war-time economic policy is conditioned by the political background against which it is planned and executed. Hence it is that the political factor finds such frequent mention in the following pages.

Thanks are due to the Manager of the Hindustan Times Press for speeding up the work of printing and thus facilitating an early publication of this volume.

30th June 1943, V. K. R. V. RAO,
University of Delhi,
DELHI.

CONTENTS.

CHAPTER I.

THE POLITICAL ECONOMY OF WAR.

It is well known that war gives rise not only to military problems but also to economic problems; and this is much more so in the case of a war like this which is a total war and is fought on the basis of economic resources and the extent and skill with which these resources are utilised for war purposes. War economy usually implies the diversion of economic resources from civilian to military purposes; and the more efficiently this is done the greater are the chances of military success. The political part of war economy arises from the fact that mobilisation of economic resources, including the extent to which diversion from civilian uses is possible and the manner in which this is achieved, are both conditioned by political factors. It would be useful therefore to give a brief account of the main aspects of the political economy of war before proceeding to discuss the effects of the war on Indian economy.

To begin with, there are a number of ways in which war brings about a diversion of economic resources. Thus, *e.g.*

(1) More men are drafted into the army,

the navy and the air force, and this means a direct withdrawal of workers from their normal peace time productive activity. When it is recalled that modern military forces require a great number of technical personnel, it is clear that the adverse effect on peace time production is considerable.

(2) More industrial and other workers are employed in the production of armaments and other military equipment. This may take the form of an increase in the output of such goods already being produced or in the production of new types of armament material. In either case, there will be an adverse effect on the volume of production of consumable goods and of capital goods required for the consumption industries.

(3) More building and allied workers are employed in military construction work such as barracks, aerodromes etc., with inevitable adverse effects on the supply of building services for the civilian population and the consumption goods industries.

(4) Even of the supply of consumption and other civilian goods—what may be called non-military goods in the sense that they have both a civilian and a military market—a good share is claimed for military use with the result that a still

smaller volume of goods and services remains available for civilian consumption.

In addition to the resources obtained by such diversion at the expense of the civilian, fresh resources not impinging upon the civilian's supplies can be obtained by increasing production. Broadly speaking, there are four ways in which the increased resources required for military use can be found: These are:

1. By increase in total production
2. By internal capital consumption
3. By reduction in civilian consumption, and
4. By borrowing from abroad or disposing of overseas assets.

Increase in total production will depend upon the extent of unemployment and under-employment of economic resources within the country prevalent at the outbreak of war. The unemployment referred to here is not merely what economists call involuntary unemployment—which is what the public understands by unemployment—but also voluntary unemployment. It will also turn upon the extent to which efficiency can be increased by better training, rationalisation, inventions etc. Some of the usual methods followed for increasing production are given below:

1. Putting unemployed resources, both labour and equipment, to work.
2. Increase in the number of hours of work, introduction of night-shifts, reduction in the number of holidays and relaxation of peace time restrictions of age, sex etc., on employment.
3. Re-entry into productive activity of pensioners and others who have retired from service, and entry into productive activity of persons who are not normally engaged in remunerative work such as women and even children.
4. Improving the efficiency of labour by technical training and other methods.
5. Improving the efficiency of productive activity by rationalisation, concentration of output etc.
6. Conducting and subsidising industrial research by which the technique of production can be improved, and substitutes found for raw materials, and other necessary articles hitherto imported.

It is needless to add that this is the most lesirable way of increasing the economic resour-

ces required for military use. The second expedient viz., internal capital consumption is not so desirable from a long-range point of view; but it has been adopted in all war economies. This consists of drawing upon stocks, and postponements of repairs and replacements of capital equipment. The extent to which the latter can be done varies, of course, with every country, depending upon the age of the equipment and upon technical factors; but it forms a substantial source of war supplies in industrial countries.

The third expedient viz., reduction in civilian consumption, is normally the most important method employed for obtaining the resources required for war purposes. This reduction may be voluntary or compulsory or may be a combination of both.

Voluntary reduction in consumption may take the following forms:

1. An austerity campaign which will lead people to economise in their consumption, postpone purchases, refrain from giving parties and travelling on pleasure, and reduce the number of domestic servants they employ.

2. Reduction in expenditure and transfer to Government of the resultant

savings in the form of gifts, subscriptions to Defence Loans etc. Subscription to loans is the most important method of voluntary reduction in civilian consumption, and to be most effective, it requires that civilian expenditure is reduced by an amount equal to the loans subscribed.

Compulsory reduction in civilian consumption takes the following forms:

1. Reduction in civilian income brought about by heavy additional taxation.

2. Reduction in civilian incomes brought about by compulsory savings schemes.

3. The two expedients mentioned above act on civilian expenditure through the medium of reductions in civilian income. There is a more direct method of reducing civilian consumption; and this is the limiting of the quantity of goods available for civilians by means of quotas and import licenceses and priorities; this in turn raises the problem of equitable distribution of the reduced supply and it is solved by a system of rationing, which ensures the availability of minimum quantities for all and prevents the free working of money power in determining the levels of personal consumption.

The fourth expedient referred to for obtaining resources for military purposes is to get them from abroad and pay for them either by disposing of overseas investments and assets or by creating overseas liabilities by borrowing. The former is possible only in the case of rich industrial countries which have got large overseas investments.

To the four expedients mentioned above may perhaps be added a fifth viz., inflation. Though inflationary expansion of currency for meeting war expenditure and the consequent drain of real income from the civilian population is not officially acknowledged as an expedient of war economy, yet it usually gets a place, particularly when the other expedients have been exploited to the full, and yet more resources are required for prosecuting the war.

The various expedients described above for obtaining economic resources for war purposes naturally involve a good deal of governmental regulation and interference with economic activity; and a number of controls are instituted. Thus e.g. imports, exports and foreign exchange are controlled, new industries are started and old ones expanded and all of them controlled, internal transport is regulated by a system of priorities, rationing is instituted, price-control is

introduced, taxation is increased and vast loan programmes are set up. All these measures involve a large measure of interference in the private lives of the people and require on their part unstinted support, readiness to put up with hardships, and disciplined and understanding enthusiasm for the war effort. To use economic terminology, there must be a sharp upward rise in the national curves of both willingness to work and willingness to save. This is possible only if there is complete understanding between the people and the Government and the latter is broad-based on the will of the former. In other words, the political *sin qua non* of an effective and and efficient war economy are:

1. Belief in the people that it is their war and that its objectives are worth suffering for.

2. Confidence of the people in the efficiency of their Government and in its conduct of the war.

3. Constitution of the Government on the basis of the popular will and the support of the people.

Finally, it may be pointed out that in most countries at war today, the political conditions mentioned above are more or less satisfied and

their war economies are therefore not subject to the complications that arise from the non-fulfilment of these conditions. We will see later that this is not true in the case of India and this fact has therefore created complications in the conduct of India's war economy, which have to be recognised and discussed in any satisfactory analysis of the effect of war upon India's economy. There are certain other features special to India which have also to be taken into account in any discussion of India's war economy. It has been considered proper, therefore, to embark upon a brief discussion of the factors special to India which distinguish her war economy from those of the other United Nations and have exercised a profound influence on the reaction of her economic organisation to the impact of war. We shall then proceed to a discussion of the effect of war upon the various aspects of our economic life and try to assess them from the point of view of both the success of the war effort and their short-period and long-period effects on Indian Economy.

CHAPTER II.

SOME BASIC FEATURES OF INDIA'S WAR ECONOMY.

The basis of the War Economy of any country is the extent of her economic resources. We have already seen that the extent of economic resources available for war depends partly upon the possibility of increasing production and partly upon that of diverting resources from civilian to military uses. The latter in turn depends upon the margin of resources available over and above the minimum necessary to keep in working order the civilian population. This margin, of course, is not a static line but will vary with many factors, particularly the political position.

Let us take up the question of increasing production. It is well known that production in India, both agricultural and industrial, is very low compared to our requirements; it is equally well known that this has been so in spite of abundant resources; and that the explanation of this paradox lies in the absence of a planned programme for increasing production on the part of the Government of India. Thus e.g., before the outbreak of war, the production of food within the country was insufficient from

the point of view of the minimum dietetic requirements of the people. The present writer estimated the deficiency for 1931-32 at 473 calories per head, mainly a result of an inadequate supply of proteins and fats.[1] Prof. Radhakamal Mukerjee has estimated the deficit for 1935 at 423 calories in each man's daily ration and points out that " if the rest of the population are assumed to obtain their average daily ration, it means that, in 1935, there was no home-grown food for 48 million Indians"[2] or 13% of the total population. The main reason for this deficiency is not inadequacy in the acreage under cultivation or in the number of milch cattle; it is the low yield of most food crops in India, and the still lower production of milk per head of Indian milch cattle. In the case of the most important food crop of the country, rice, the yield per acre is only 988 lbs. as against 2,433 in China and 3,070 in Japan. As for wheat, the yield per acre is 811 lbs. as against 989 in China and 1,350 in Japan. Sugarcane, on which the most research has been done and the largest area sown with

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1. Vide the author's paper on " A Note on the Inadequacy of India's food supply in relation to some dietetic requirements " in the Proceedings of the Indian Statistical Conference, 1938.
2. pp. 12-13—" The Food Supply "—Prof. Radhakamal Mukerjee.

improved quality cane, shows an output of only 13 tons per acre as against 19 in Mauritius, 29 in Formosa, 48 in Java and 65 in Hawaii. The position is similar in the case of the other important food crops in the country. As regards milk, a large proportion of Indian cows don't produce any milk at all; while the average yield from those which do is not comparable with that in other countries. Even the she-buffalo, which the Royal Commission on Agriculture described as the real milk producing animal of India, has an average yield of milk far below that in western countries. As Mr. Duckham has pointed out, "The cattle population of India is the largest, the most dense per acre of cultivated area and per person, and probably one of the least efficient in the world."[1] In fact, the average annual milk yield per head of milch cattle amounted to only 753 lbs. in India as against 7005 lbs. in Denmark, 5576 lbs. in England, and 7559 in Holland.[2]

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1. p. 200 "*Animal Husbandry in the British Empire.*" cf. also Keatinge "As compared with the dairy farmer in Europe the Indian dairy farmer is at a disadvantage from the fact that cows and buffaloes in India give far less milk than is given by any cow whose existence would be tolerated in Europe"— p. 115 "*Agricultural Progress in Western India.*"

2. Further details are given in the footnote found in the next page.

The position regarding industries was also not satisfactory. The total number of workers employed in factories in 1938 was only 1.7 millions, while the corresponding numbers were much larger in other leading countries of the world. The country was also dependent on foreign sources for a large part of her requirements of industrial and manufactured goods; thus in the year preceding the war, imports of manufactured goods totalled a value of Rs. 84.13 crores.[1] The most disquieting feature of the situation from the point of view of war economy was the practically complete absence in India of

Footnote 2 of preceding page.

Approximate milk yield per cow (*in lbs.*)

Denmark	..	..	7,005
England & Wales	..	..	5,576
Germany	..	..	5,305
Holland	..	..	7,559
Scotland	..	..	5,386
Switzerland	..	..	6,498
Canada	..	..	3,195
U.S.A.	..	..	4,126
Japan	..	..	5,857
New Zealand	..	..	5,118
Egypt	..	..	2,663
INDIA.			
Cows	..	..	525
She-buffaloes	..	..	1,270
Average	..	..	753

1. Footnote given on the next page.

the basic industries on which depends the possibilities of increasing industrial output. The only exception was the iron and steel industry ; otherwise we had neither the heavy chemical nor the heavy engineering industries in the country. Machinery and machine tools had mostly to be obtained from abroad. There was

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Footnote 1 of preceding page.

1. Details are given below :—

1938-39.		(in crores of Rs.)
Chemicals, Drugs & Medicines	..	5.62
Cutlery, Hardware implements and instruments (excluding electrical instruments.)	..	5.81
Dyes and Colours	..	4.03
Electrical goods & apparatus (other than machinery.)	..	3.32
Glassware and Earthenware	..	1.65
Machinery of all kinds	..	19.72
Metals—iron & steel and manufactures thereof	..	6.65
Metals other than iron & steel and manufactures thereof	..	4.16
Paper—pasteboard & stationery	..	3.90
Rubber manufactures	..	1.41
Vehicles	..	6.68
Cotton yarn & manufactures	..	14.15
Silk ,, ,,	..	1.32
Woollen ,, ,,	..	2.20
Other yarns & textiles fabrics	..	3.51
TOTAL	.. ..	84.13

no ship-building or automobile industry; nor were locomotives or internal combustion engines manufactured within the country. As regards labour, there was a great dearth of skilled workers; and no arrangements had been made by Government to remedy this vital deficiency in India's industrial potential. It was obvions therefore that there would be great difficulties in the way of India's operating as a base of industrial or food supplies without adequate and speedy attention being paid to the lacunae in her industrial and agricultural structure.

From the political point of view, also, conditions were not satisfactory. India was declared a belligerent without any previous consultation either with the eleven elected provincial governments that ruled in the different provinces or with the leaders of the major political parties who formed the elected part of the Central Legislative Assembly. The Congress-controlled ministries in eight provinces resigned in protest and popular governments came to an end in those areas. The Congress Party also withdrew from participation in the proceedings of the Central Legislature. Neither the country nor the Congress was pro-Axis; on the contrary, anti-fascist feelings dominated the politics of the country long before and after

Munich. The real grievance was that the successful participation of India in the War demanded the guidence of a popular government at the Centre, and in July 1940, the Congress formally offered its wholehearted co-operation in the war, subject to the formation of a national government. The British Government declined to accept the condition and offered instead an increase in the Indian personnel of the Governor-General's Executive Council, with no change in the Viceroy's constitutional position. The Congress was disappointed and turned in its distress once again to Mr. Gandhi, who thereupon inaugurated the campaign of individual civil disobedience. The campaign proceeded for more than a year till at last pressure of public opinion here and abroad and new perils on India's own borders impelled the Government to release the Congress leaders and prepare the stage for a political rapprochement. Sir Stafford Cripps came out to India in 1942 and offered the country independence after the war and Indianisation of the Executive Council during the war, but with no change in the Viceroy's constitutional position. It may be necessary to recall here that constitutionally, the Viceroy's position is supreme and his Executive Council, selected by him on a personal

basis, could only act as his adviser. There was no assurance forthcoming either that in practice the Viceroy would refrain from exercising his veto in cases when a large majority of his Council held a different opinion. Congress found itself, therefore, unable to accept the Cripps offer; the other parties followed suit and the political clouds once more resumed their dark and sombre hue. It is of course a moot question whether it was either wise or even right for the Congress consequently to prepare for a campaign to force Government to accept its plea for a national government, when Government's refusal to do so was bound to lead to a situation in the country that would certainly not help the interest of the world's anti-fascist forces. But in politics things are not usually decided by cool reason or sober calculation. The Congress Party with its long and consistent anti-fascist and anti-Axis record felt that the best way of defeating Japan and hastening the victory of the United Nations was by the formation of a National Government that would mobilise the entire resources of the nation in a manner that only a popular government can; and we have already seen that the political *sin-qua-non* for a total war in the economic field is a people's government. The British Government probably

felt that Mr. Gandhi's well-known pacifism would come in the way of the war effort, if a national government were to take the place of the present government which, constitutionally, is only a subordinate branch of His Majesty's Government. Anyway the breach was made and the subsequent tactics pursued by the British Government were not calculated to smoothen matters. Bitterness grew on both sides; and when the All-India Congress Committee authorised Mr. Gandhi to inaugurate a mass civil disobedience campaign in pursuance of the demand for a national government, Government immediately arrested the Congress leaders, even though Mr. Gandhi had declared his desire not to precipitate matters and wanted to interview the Viceroy to explore the avenues for a peaceful settlement. The subsequent events in India are too well known to need mention. Government was able to restore law and order, as undoubtedly they could do with their command over organised and disciplined armed forces. But political peace certainly has not been restored. Popular feeling is sullen and bitter; and Government continues to be a bureaucratic organ, perhaps efficient in its own way but bearing no semblance to a national or popular government. This fact has to be emphasised, for out of it arise con-

sequences bearing on India's war economy which otherwise may not have arisen. Thus e.g., the immense psychological force underlying the feeling that it is their war fought by their government for a cause in which they believe—a force which kept the Axis at bay in England in the dark days of 1940 and found ringing expression in Mr. Churchill's "blood, sweat and tears" oration, and one which sustained the Russian armies even when Hitler was within striking distance of Moscow and led them later to hurl his armies back—that force cannot be said to underlie the incentives behind India's war effort in the same manner. The nation's will to work and to save has received no extra psychological stimulus; and yet, as the war requires a strengthening of both, the other and, really speaking, peace-time incentive has had to be requisitioned; this is the money incentive. How this has meant a fundamental difference in our war economy as compared to those of the other belligerent nations will be seen in the succeeding pages.

The third peculiar feature underlying India's war economy is also well known. India is not merely a belligerent power, but she has also to function as a supply base for the other United Nations, particularly, Great Britain. Because of India's geographical position and her

vast resources (vast in the aggregate, though not perhaps with reference to her requirements) India was called upon to supply agricultural and industrial material for the use of the allied forces in the Near East, the Middle and the Far East. In addition to her own war expenditure totalling over Rs. 466 crores since the outbreak of the war upto March 1943, she has had to furnish supplies totalling a value of more than Rs. 600 crores for His Majesty's Government. It is true that this is paid for, but as the payment is neither in goods nor in gold, its pressure on the real resources available to the country remains the same. In addition, India has had also to meet the civilian requirements of her Allies which were left unsatisfied on account of the diversion of their own industries to war purposes; and this has also meant in the short period an increase of the pressure on Indian production, even though it may mean an increase in her resources in the long period. In other words, India's economy has had to adjust itself as a result of war not only to the release of the resources required for her own war effort but also that required for a part of the war effort and also civilian requirements of her Allies. This has made the problem of organising India's war economy more complicated and vaster in its content of real costs; and the effect of this will be

traced in greater detail in the following pages.

To sum up, the basic features of Indian economy described above have complicated the position and differentiate it from the war economies of the other belligerent nations. Indian resources, vast though in the aggregate, are insufficient from the point of view of her domestic peace-time requirements; her supply both of food and industrial consumable goods are inadequate, while she is dependent upon external sources for the basic material which determine the pace of increasing the quantity of either of these outputs. Scarcity was thus the keynote even of India's peace-time economy; and this was bound to prove even more so with the demands of war upon the limited supplies of the country. When it is remembered that Indian economy was to be called upon to sustain not only the weight of her own war expenditure but also to include supplies for His Majesty's Government and supplies for the civilian populations of some of the United Nations, it was clear that the need for meeting these extra requirements by an increase in total productive effort rather than by a diversion of effort from civilian supplies was more urgent and necessary for India than perhaps for any of the other belligerent nations. It was also clear that much greater calls would

have had to be made for co-operation from the public by way of contributions to taxes and loans for financing the war effort. At the same time the political *sin-qua-non* for increasing output and raising the national curve of willingness to work and willingness to save is largely absent in India. This was bound to lead to reliance being placed on the money motive for increasing output and on the currency mechanism for financing the war effort. In the absence of a political settlement, scarcity and inflation were likely to prove the peculiar features of Indian war economy, peculiar not so much for their existence as for their quantitative magnitude. We shall see in the following pages, where we discuss in detail the effects of the war on Indian economy, how these two factors manage to dominate the situation, and create economic problems for the Indian Government, vastly more difficult than those facing even the most involved of the belligerent powers. All this could have been avoided if only Government had appreciated the peculiar features of India's war economy and taken necessary action for incrceasing output and obtaining the people's co-operation in financing the war effort. The results of their failure to do so have given an altogether different turn to the economic consequences of the war in India and led to the acuteness of the problems of scarcity and infla-

tion that form the crux of India's war economy today. In the following pages we proceed to discuss in detail the effects of the war on Indian economy and Governments's war time economic policy, ending up with some constructive suggestions for dealing with the problems of both the war-economy and the post-war economy of India.

CHAPTER III.

THE WAR AND INDIAN TRADE.

To begin with, the effect of the war was directly felt on our foreign trade, and through it, on other branches of economic activity. Trading with enemy countries came to a complete stop. Large markets for Indian goods were therefore lost, while certain essential supplies we were getting from abroad also suffered contraction. Some idea of the magnitude of this factor can be obtained from the fact that the total value of such trade amounted, on an average, to Rs. 1123 millions in the pre-war period of which exports accounted for Rs. 527 millions and imports Rs. 596 millions. It must be pointed out that these figures refer not only to the trade lost by the war in Europe, but also includes the trade lost by the war with Japan and the occupation by her of several countries in the east. Details of the normal magnitude of this based on the pre-war quinquennial period are given below :

ANNUAL AVERAGE FOR THE YEARS 1934-35 to 1938-39.

EXPORTS.

Description.	Value (in millions of Rs.)
Cotton raw ..	244.6
Cotton waste ..	2.8
Cotton manufactures.	44.0
Iron and Steel ..	15.7
Tea ..	.4
Coffee ..	3.6
Hides & Skins (raw..	9.8
,, ,, (tanned).	1.7
Jute raw ..	70.6
Jute manufactures ..	40.9
Coir manufactures ..	2.9
Groundnut ..	65.4
Linseed ..	2.9
Hemp raw ..	2.3
Oil cakes ..	4.7
Manure ..	2.4
Lac ..	1.4
Oil seeds ..	1.7
Groundnut oil ..	2.6
Manganese ore ..	2.5
Gram and pulse ..	1.4
Rice ..	.9
Provisions ..	.8
	526.7

IMPORTS.

Description.	Value (in millions of Rs.)
Cotton Textiles ..	72.2
Silk ,, ..	14.3
Woollen ,, ..	14.5
Artificial silk ..	29.9
Drugs & medicines ..	10.1
Dyeing & Tanning substances ..	22.0
Chemicals ..	8.6
Iron & Steel ..	22.4
Copper ..	3.9
Brass ..	7.1
Tin ..	6.8
Aluminium ..	2.2
Machinery ..	30.8
Hardware ..	12.6
Instruments ..	14.4
Motor Vehicles ..	3.8
Glass & Glassware ..	0.5
Silk raw ..	4.0
Sugar ..	4.4
Paper & pasteboard ..	13.9
Haberdashery & millinery ..	4.6
Stationery ..	3.0
Precious Stones ..	7.0
Pulp & paper making material ..	.5
Earthenware ..	2.2
Kerosene Oil ..	51.0
Petroleum ..	32.2
Lubricating oil ..	8.8
Vegetable oil ..	5.2
Camphor ..	1.2
Liquor ..	4.1
Provisions ..	3.6
Starch & farina ..	2.9
Rice in husk ..	4.8
Rice not in husk ..	118.6
Teak wood ..	19.1
Toys ..	2.5
Spices ..	13.2
Fruits & vegetables ..	4.5
	596.4

To take the exports first, Oil seeds, hides and skins, cotton, and jute were the principal sufferers: this was reflected in a slump in their prices with some exceptions which lasted till about the end of the second year of war. But, with the progress of war new markets were opened up for some of these goods either abroad or within the country: thus the expansion of the Indian Cotton Textile industry meant more consumption of Indian cotton, while the large Government orders for leather and leather goods increased Indian demand for hides and skins. On the whole the initial fall in the export trade was more than off-set by subsequent developments arising from the war. The fall in imports however has proved a more serious affair and has led to acute shortages in several categories of essential goods such as paper, drugs and medicines, dyes and colours, metals and metal ware, glassware and earthenwares, surgical instruments, electric bulbs and other electrical goods, machine tools, vehicles and all types of machinery. There is no doubt that this decline in imports has had a substantial effect in raising the level of prices in the country; and while some substitutes have been found either by imports from allied countries or by domestic manufacture, there is no denying that the shortage in the supply of many of the

goods formerly imported from the enemy countries is both real and substantial.

But the war may also be said to have had its compensations in regard to foreign trade. Our exports to the Allied countries have risen a good deal in value, though not in quantity; the published figures do not include the value of goods exported on Goverment account and the omission is substantial, as it includes goods bought by the Indian Government on behalf of His Majesty's Government and other Allied Governments. The following statement gives the figures of the value of exports on private account from the beginning of the war:

VALUE OF EXPORTS.

		(in millions of Rs.)
Sept. 1939 to August 1940	—	2126.47
,, 1940 to ,, 1941	—	1877.14
,, 1941 to ,, 1942	—	2282.76
,, 1942 to December 1942	—	697.70

When it is recalled that the value of exports for the year ending August 31st 1939 was on only Rs. 1737.3 millions and this included all exports, it will be seen what a substantial addition in terms of value has been made to our export

trade. The loss of enemy export markets has been more than made up as far as aggregate value is concerned; and in addition, a significant change has been brought about in the composition of our export trade. This later fact is clear from the statement given on page 29 [1]

This increase in the exports of manufactured goods has had the effect of further accentuating the shortage of manufactured goods in the country. No doubt part of the increase in these exports has been found from increased production but a good part of it has been at the expense of domestic consumption, notably so in the case of cloth; and this has had the effect of helping to bring about a rise in prices. There is equally no doubt that if the country had been better industrialised during the decade preceding the outbreak of war, the position would have been entirely different. Here then is the effect of one of the basic factors we mentioned in the preceding chapter viz., the low industrial potential of India on the eve of the war and consequent reliance on diversion rather than increase to obtain the required supplies of industrial goods.

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1. The figures in columns 3 to 6 do not take account of exports on Government account; but the result is not likely to be different.

VALUE FIGURES IN MILLIONS OF Rs.

Categories of Exported goods.	1938-39		1939-40		1940-41		1941-42		1942-43	
	Value	%	Value	%	Value	%	Value	%	Value	%
I. Food, Drink and Tobacco.	392.3	24.1	398.3	19.5	418.3	22.3	582.9	24.5	469.5	25.0
II. Raw materials & produce and articles mainly unmanufactured	732.2	45.0	859.8	42.1	618.6	23.1	653.3	27.5	428.3	22.8
III. Articles wholly or mainly manufactured.	475.8	29.2	758.2	37.3	810.6	43.3	1092.5	45.9	952.9	50.8
IV. Rest.	27.4	1.7	22.9	1.1	21.4	1.3	43.3	2.1	25.3	1.4
Total.	1627.7	100.0	2039.2	100.0	1868.9	100.0	2372.0	100.0	1876.0	100.0

The shortage in imports caused by the stoppage of trade with the enemy countries has been made up to some extent by an increase in the imports from Allied countries; but not completely, and certainly not in the quantum and varieties of goods imported. This can be seen, though not quite clearly, from the statement of the value of total imports into the country given on page 31.

Domestic production has not taken the place of the fall in imports to any substantial extent and not at all in many fields; while there has been, as we already saw, an increase in the exports of manufactured goods. This is clear from the following statement of the value of exports and imports of manufactured goods in the prewar year and in the succeeding war period:

VALUE IN LAKHS OF Rs.

Period	*Exports*	*Imports*	*Net Exports.*
1938-39	4757	9277	−4520
1930-40	7583	9181	−1598
1940-41	8107	8951	− 944
1941-42	10926	9368	+1558
1942-43	9529	4948	+4581

It must also be pointed out that the fall in the quantity of imports of manufactured goods in even greater than is indicated by the figures

VALUE FIGURES IN MILLIONS OF Rs.

Categories of goods Imported.	1938-39		1939-40		1940-41		1941-42		1942-43	
	Value	%	Value	%	Value	%	Value	%	Value	%
I. Food, Drink and Tobacco.	240.0	15.8	352.9	21.3	238.1	15.2	278.4	16.1	76.2	6.9
II. Raw materials and Produce mainly unmanufactured.	331.8	20.4	361.3	21.9	420.9	26.8	500.0	28.9	519.5	47.1
III. Articles wholly or mainly manufactured.	927.7	60.9	918.1	55.5	895.1	57.0	936.7	54.0	494.8	44.8
IV. Rest.	23.8	2.9	20.6	1.3	15.6	1.0	17.8	1.0	14.0	1.2
Total.	1523.3	100.0	1652.9	100.0	1569.7	100.0	1732.9	100.0	1104.5	100.0

given above on account of the steep rise in the prices of imported commodities. All this has led to a substantial shortage in the supply of manufactured commodities and enormous rises in the prices of articles of urban consumption like drugs and patent medicines, electrical bulbs and other goods, rubber goods, knives and blades, pen and ink, watches, crockery and cutlery, glassware, furniture, paper etc. This should have meant a vast scope for increased industrialisation; that this has not proved so in practice is largely due to the absence of the basic industries in India. If only India had possessed the heavy engineering—including automobiles, shipbuilding, machine tools and machinery and locomotives—industries, and the heavy chemical industries on the eve of the war, this war should have had the same effect on India's industrial economy which the last war had on Japanese economy; but that was not so; and the result has been an acute period of commodity inflation accompanied by the spurious appearance of monetary prosperity caused by rising prices. The responsibility for this result clearly rests with the Government of India and their failure to provide the basic framework of industrial development in this country in the pre-war period, in spite of clear and repeated requests from the industrial and political interests in the country.

It must also be pointed out that in spite of the advantageous position in which India was placed with respect to foreign trade in the sense that she was now exporting more of manufactured goods and importing less of them, the terms of trade were not moving in her favour. In other words, the value of unit imports was rising faster than that of unit exports with the result that a proportionately greater quantity of exports had to be given in exchange for a given quantity of imports. This is seen from the following table, which contains figures of the index numbers of the delared value of imports and exports:

BASE 1937-38 = 100

Year	Unweighted Index of declared Values per unit of		Index of unit value of imports ÷ index of unit value of Exports.
	IMPORTS	EXPORTS	
1939-40	71.50	65.75	109
1940-41	86.25	71.67	120
1941-42	104.92	84.83	124
1942 43 (7 months)	126.29	93.43	135

It is clear from this table that our imports are now costing the country 35% more per unit than what they did in 1937-38 and 24% more than what they cost us during the first year of

the war. With better control over our foreign trade, this is a result which could have been avoided. Incidentally, it has also helped to raise the price level, particularly of the goods generally used by urban consumers.[1]

As for the direction of our trade, it was but natural that the share of the British Empire should rise; for trade with enemy-occupied countries was forbidden, and further, exchange control was being exercised in such a manner as to encourage Empire or sterling trade and to discourage imports from the non-sterling or non-empire countries. That the trade with U.S.A. increased in spite of this is largely due to the war-time inability of the Empire countries to meet a number of India's import requirements and also to America's demand for Indian goods. The relevant figures are given on page 35.

1. If we take the unweighted indices of declared values per unit of exports and imports for the first quarter of 1938-39 and compare them with those for 1942-43, we find the rise in the import price price level to be 111.7% as compared with a rise of only 56.7% in the export price level. There is thus no doubt about the increasing costliness of imports in terms of exports.

FIGURES IN MILLIONS OF Rs.

	EXPORTS			IMPORTS			BALANCE OF TRADE		
	British Empire	U.S.A.	Other countries.	British Empire	U.S.A.	Other countries.	British Empire	U.S.A.	Other countries.
1938-39	853.7	138.8	635.3	885.4	97.7	540.3	-31.7	41.1	95.0
1939-40	1140.3	244.0	654.8	930.8	149.2	572.7	209.5	94.8	82.1
1940-41	1166.1	258.9	444.0	899.1	270.1	400.5	267.0	-11.2	43.5
1941-42	1488.5	463.9	419.8	1056.5	346.1	330.4	432.0	117.8	89.4
1942-43 (9 months)	959.2	214.4	272.4	499.8	147.5	180.6	459.4	66.9	91.9

The balance of trade was in India's favour from both Empire and non-Empire countries.

It is needless to add that all these changes in the volume, composition and direction of our foreign trade were facilitated by the Controls instituted during the war. Both imports and exports were licensed and nothing could be either exported or imported without a permit. Import controllers were appointed to whom applications had to be made for permission to import goods in to the country, while the procedure was much simpler with regard to the obtaining of export licenses. In fact, much greater control has been exercised on the volume of imports than on that exports. This can be understood in the case of countries which have unfavourable balances of account and have therefore to conserve their foreign exchange balances. In the case of India, however, the problem was not one of having to find foreign exchange but that of what to do with foreign exchange that went on accumulating almost automatically. In fact, Indian conditions required a greater control of exports, partly because exports increased the favourable balance of trade and with it the accumulation of sterling balances and an expansion of Indian currency; and partly because exports meant largely a reduction in domestic supplies with a consequent rise in prices and in the cost of living. There is no doubt that shortage of shipping space has had a great deal

to do with this restriction in imports; but it seems also clear that the absence of an Indian shipbuilding industry, the desire to conserve foreign exchange resources in line with the policy laid down by the Bank of England, and an unduly narrow and short-sighted interpretation of the term 'military requirements' have all played an important part in bringing about this fall in imports. But all this does not explain why a more vigorous control was not imposed on exports. There was a good case for restricting exports to purely military requirements from the point of view of better enabling India to stand the impacts of a war economy. The argument that may be advanced that India has now got an opportunity of finding new markets is not very convincing firstly because it is doubtful if these markets can be retained at the end of the war, and secondly—and this is more important—because the Indian market is far more important than any foreign market can be. Moreover, allowing the free play of foreign civilian demand meant not only a reduction in the quantum available for domestic consumption but also a pushing up of prices which affected even the reduced supply left for Indian consumption. This is particularly exemplified in the case of cloth where it is well known

that export demand has played the largest part in pushing up prices. Under these circumstances, it seems probable that either Government did not fully appreciate the effect on India's war economy of their policy regarding exports or that they were too much concerned with keeping export markets supplied with Indian goods, even at the expense of domestic consumption. The net result has been that Government's policy regarding foreign trade has added to the scarcity of civilian supplies. Looking to the effect which this scarcity has had on the inflationary trend in India, surely the time has come now for a revision of Government's policy regarding our foreign trade; and the urgency for effecting this revision is reinforced by Mr. Churchill's expectation that the war would last for another 3 or 4 years. The main change which is required is a stricter control—and even prohibition if necessary—of exports on private account; and a vigorous attempt at obtaining more imports, not only for what are called military 'requirements' but also for the purpose of expanding the equipment that underlies India's industrial potential and would enable her to increase the output of manufactured goods. Such a policy will offset the shortages induced by the war, make a frontal attack on the problem of scarcity, and stabilise the cost of

living in India with a resulting encouragement of civilian morale and a reduction in the cost of the war both for India and for the United Nations. It is gratifying to note in this connection that, after nearly four years of war, Government have at least recognised the need for exercising stricter control over the volume of exports in the interests of domestic consumption. Thus they have now agreed to stop the export of foodgrains from this country and drastically curtail the export of cloth. They have also begun to perceive the need for obtaining imports that will raise the industrial potential of the country as witnessed by their large orders for locomotives and waggons during the current year and their expressed intention to facilitate the import of power alcohol plants; but this is not enough. If the war is going to last for another three years, it is highly important that facilities should be provided for the immediate establishment and equipment of the heavy engineering and the heavy chemical industries in India. These alone can really raise the industrial potenial of the country to the desired heights and enable India not only to meet her own present appalling shortage of manufactured goods but also facilitate the supply of goods to neighbouring theatres of war. Let us hope that the newly

created Civil Supplies and Industries Department will take up this question in right earnest and cause a revision of import policy which will help in building up the country's industries and thereby ensure civil supplies not only for herself but also for her needy neighbours.

CHAPTER IV.

THE WAR AND INDIAN TRANSPORT.

The dependence of Indian economy on adequate, efficient and cheap transport has not always been realised-and it requires a war to bring this fact clearly to the notice of even the government of the country. But it is obvious that in a country as large as this, with industries largely localised, where in addition a certain measure of specialisation has taken place even in our agriculture, large movements of both manufactured and other goods have to take place in order to keep our economy going and enable the people to obtain their normal supplies of food, clothing and other essential commodities. No reliable computations of the value of internal trade have been made so far, but a recent estimate I saw places it not less than 12 times that of our foreign trade and this enormous volume of internal trade depends for its carriage on rail, road and coastal transport. It must be pointed out, however that the internal transport system lacks self-reliance. Railways are dependent upon foreign sources for locomotives ; roads are dependent upon foreign sources for motor vehicles, and these vehicles are dependent upon foreign sources

for their fuel in the form of petrol: coastal transport is also largely dependent upon foreign sources for their steamers. This dependence on foreign sources for the basic requirements of internal transport is a source of weakness in Indian economy, particularly when the supply of tranport equipment falls with a simultaneous increase in the demand for transport facilities.

Thus the position on the eve of the war was quite unsatisfactory from the point of view not only of meeting the increased demand for transport facilities that war brings in its train but even from that of maintaining at their pre-war level the volume of transport facilities available in the country. The unsatisfactoriness rose from the fact that the country had not developed within its borders industries that could manufacture locomotives, ships and marine-engines, and motor vehicles and motor fuels alternative to petrol such as power alcohol. And this was in spite of numerous and persistent demands from the people for the establishment of these industries. Situated as we are, and in view of the vast quantities of capital involved and the fierce competition these industries will have to face from their experienced and established foreign rivals, it was obvious that only active and vigorous encouragement from Government, if

not Government initiative itself, could bring these industries into existence. It is needless to add that such encouragement was not forthcoming. The result was the unsatisfactory transport position that has contributed to the shortage of food and other articles in many parts of the country : and played a significant part in causing rises in the cost of living and the level of prices in the country.

The position regarding rail transport was further aggravated by certain other developments following the war. First, a considerable quantity of rails, waggons and locomotives were exported from the country, exact figures of which are not available and will not be avaliable till, I suppose, the end of the war.[1] Some indication of the effect of this fact on Railway transport

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1. cf Mr. Tyson, in his lucidly written account of India's War effort "INDIA ARMS FOR VICTORY", refers to the important part played by India in supplying rail transport facilities for Egypt, Libya, Iran and Iraq by exports of rails, locomotives and waggons. Mr. Tyson points out that in enlarging communications in the Middle East, "India took a big hand" while "in Iraq and Iran, which came within the orbit of military operations later on, railway lines were few and not well equipped. In bringing them up to the required standard, India has played a major role", pp. 99-100. When it is remembered that India produces no railway equipment herself, it will be clear that all this has been at the expense of a fixed quantity of domestic supply which at the same time has had to meet a greatly enlarged internal demand due to military operations.

facilities is, however, available from the following figures.[2]

Statement of Rolling Stock on 31st March.

	1939	1942	Difference.
Broad gauge locomotives	5,300	5,313	+ 13
Metre ,, ,,	2,323	2,212	− 111
Narrow ,, ,,	296	281	− 15
Total.	7,919	7,806	− 113
Broad gauge waggons	149,131	147,947	− 1,184
Metre ,, ,,	52,299	46,797	− 5,502
Narrow ,, ,,	3,587	3,476	− 111
	205,017	198,210	− 6,797

As for railway lines, Mr. Tyson points out that a considerable number of small lines have already been dismantled and adds that "Taking a target quantity it is quite likely that by the end of the War, India will have had to supply between five and six thousand miles of railway track, as well as several hundred bridge girder spans."[3] (India started with a totai railway mileage of 40,000 on the eve of the war).

2. Compiled from Railway Board Reports.

3. Ibid. p. 101.

Secondly it is well known that the optimum capacity of a railway plant depends on the promptness with which the minimum replacement programme is carried out. Even more important is the need for repair facilities which are required in greater measure when railways are subject to unusual strain. Thus, as Mr. Tyson points out, "A certain number of engines remaining for ordinary domestic use are always under repair in the workshops or sheds and they are not available for operation. Approximately, one out of every six locomotives in service is withdrawn from the line for this reason".[1] But the repair facilities available to the railways have not only been not extended, but have actually diminished owing to diversion towards the production of munitions. Thus, Indian Railway workshops are turning out hand grenades, shell bodies and parts, fuse components, aircraft parts and munitions and armoured vehicles. "Complete workshops were handed over to the Supply Department, the first early in 1940, the second a year later and a third in October 1941;[2] in addition a number of workshops are devoting a

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1. Ibid. p. 95.

2. Ibid. Tyson, p. 103. For an interesting account of details of this diversion the reader is asked to see pages 103-106 of the same book.

part of their resources for the same purpose. All honour of course to the Indian Railways for the skill and efficiency with which they have discharged this task, but its effect on accentuating transport shortage in the country has also to be accepted. This latter consequence need not have happened, if only the country had been aided to possess a heavy engineering industry in the pre-war decade as was being repeatedly urged by Indian public opinion.

Thirdly, the entry of Japan into the war and the conquest of Burma made the east coastports unsafe for normal transport and this meant a diversion of oceanborne and coastal traffic to the west coast and a consequent additional strain on the railway systems catering to the eastern parts of India. Fourthly, the disturbances that followed the arrest of Congress leaders in August last also added their quota to the strain on Indian Railways. All this has meant shortage of railway transport; and yet the demand for it grew apace on account of war requirements. It must be added to the credit of Indian Railways that they rose to the occasion—no doubt at the expense of the duration and post-war efficiency of their rolling stock equipment—and actually carried an increased goods traffic of 30% and an increased passenger traffic of 17%. But it must not be

forgotten that civilian traffic was at a considerable disadvantage[1] and this in turn contributed to widespread shortages of food and other essential goods in different parts of the country. It is not possible to give any quantitative estimate of this failure of railway transport supply to cope up with civilian demand, but it is undoubtedly of a substantial order of magnitude.

As regards road transport, it had been increasing in importance during the last 20 years; and on the eve of the war, road transport played a considerable part in catering to both passenger and goods traffic. The length of road mileage in the country in 1938 was 54,892 metalled and 220,889 unmetalled. The number of heavy

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1. cf. the Report of the Railway Board 1941-42. "The strain on railways on account of the war increased greatly during the year. Military traffic reached unprecedented levels, supplies similarly increased and industries throughout the country expanded steadily. The slack period, which was a normal feature of railway working during the summer months, disappeared completely in the summer of 1941 and railways were therefore not in a position to make up arrears of traffic which had accumulated during the previous busy season. Alternative means of transport contracted seriously and while all essential traffic moved, *railwys were not able to meet in full all the demands placed on them*". (*italics mine*)

motor vehicles (lorries, buses etc.) in the country was 39,922 on the 31st March 1939, while annual imports during the 10 years preceding the war numbered, 12,090 motor cars and 8,718 omnibuses. The war saw a big reduction in the imports of motor vehicles; in fact, motor vehicles cease to appear in "Imports" from 1940-41 onwards. This probably means that no imports of motor vehicles were permitted for civilian purposes. At the same time military demand for these vehicles increased manyfold and it was inevitable that this should be met, partly at any rate, at the expense of domestic stocks. This meant in turn a reduction in the number of vehicles operating on the roads and a consequent shortage of transport facilities, especially for the areas normally not served by railways. This process was further accelerated by the shortage in petrol which soon began to make its appearance under the stress of military demand and the occupation by enemy forces of oil-supplying centres in the East. Rationing of petrol was introduced and drastic reductions were made in the amount available for civilian consumption. The country possesses abundant reserves of the raw materials for manufacturing an alternative motor fuel but no attempt was made to set up a power alcohol industry in this

country either before the war or even during the earlier periods of the war when it was easy to obtain the necessary plant from the United States of America. Even now we are in the stage of having indented for power alcohol plants, but they have not arrived yet. The net result has been, therefore, a further accentuation of the transport shortage in the country.

The position was equally unsatisfactory regarding coastal transport. Coastal transport played an important part in carrying on the trade of the country, as can be seen from the fact that the annual average value of coastal trade during the 10 years preceding the outbreak of war amounted to as much as Rs. 151.05 crores. Most of the merchandise carried was of Indian manufactures, the annual average figures for the 1929-30 to 1938-39 being as under

(In millions of Rs.) [1]

	Exports	*Imports*	*Total*
Domestic merchandise.	677.5	673.8	1351.3
Foreign merchandise	60.9	76.9	137.8

1. Government Stores accounted for the following portion of these figures :

(In millions of Rupees)

	Imports	*Exports*	*Total*
Indian ..	7.2	5.2	12.4
Foreign ..	2.0	1.7	3.7

During the war, coastal trade in private merchandise has been reduced to insignificant proportions, most of the ships engaged in coastal traffic having been requisitioned by Government for mine-sweeping and other Government purposes. As there is no indegenous ship-building industry, it has not been possible to replace the ships withdrawn from private trade ; and this has meant a further accentuation of the shortage in transport. One consequence e. g., has been that traffic from the Punjab which formerly used to go to Bengal by sea via Karachi is now diverted to the raliway system ; and this additional pressure on railway transport facilities is exercised at a time when the rolling stock available for civilian traffic has actually undergone diminution.

To sum up, the war has brought about an enormous shortage in the sum total of transport facilities available for non-military traffic. This has led to local shortages in supplies of essential articles followed by profiteering, hoarding and rise in prices. The tragedy of the situation is that it is not a shortage of raw materials or labour that has prevented that expansion of transport equipment and motor fuel which would have averted the crisis. It is the non-establishment in the country of the necessary industries—locomotives, ship-building, automobiles and power

alcohol — during the pre-war decade that explains the situation; and for this, responsibility has to be placed on the Government of India and its lackadisical industrial policy during the two pre-war decades. The argument that this would have been remedied if the Government of India had anticipated the occurence of war and they only shared this failure to anticipate war with all other allied nations and therefore deserve no special blame has been put forward by some writers;[2] but it must be pointed out in reply that, war or no war, the economic development of the country required the establishment of these industries; and as these industries could not have been established without substantial aid from Government, it is not possible to absolve the Government of India and their half-hearted industrial policy from all blame for the present transport situation in the country.

In the next chapter we turn to the effect of the war on Indian agriculture and especially on the food supply of the country.

2. Mr. Tyson has put forward this view rather forcibly in his book. *India arms for Victory.*

CHAPTER V.

THE WAR AND INDIAN AGRICULTURE.

The position of the Indian cultivator on the eve of the war was certainly not satisfactory. Prices of farm products which had fallen to disastrously low levels in 1930 and 1931 had not yet recovered to their pre-1929 positton; while the real burden of agricultural debt had increased so much that, during the decade 1929-1939, provincial governments had as one of their chief pre-occupations the devising of legislative and other measures for the reduction of the cultivator's debt.

As regards food supplies, the country was not self-sufficient from the point of view of its basic requirements. We were dependent upon Burma for part of our supplies of rice; even in the case of wheat, the pressure of increasing population and of domestic demand was being shown by the fact that, whereas, before 1914, export of wheat was an important item in our foreign trade and constituted 14% of domestic production, it had practically ceased to figure in our foreign trade by 1939; in fact, we had actually begun to import wheat in the years immediately preceding the outbreak of war. Moreover, even taking both imports and

domestic production into consideration, supplies of food were normally insuffieient to meet the country's basic dietetic requirements; though from the point of view of market demand at ruling prices, there was no deficiency in supply.

It must be pointed out, however, that there were considerable differences between the different regions of the country in regard to the extent to which they produced their own food supplies.* Punjab and U.P., e.g., produced more

* Some idea of this can be had from the following statement showing the calory value of the food, including meat and milk, available per head in the different provinces from their home production. The figures are for the year 1931-32:—

Madras	..	2444
Bombay	..	2650
Bengal	..	1563
Punjab	..	3870
U. P.	..	4388
C. P.	..	2324
Assam	..	2235
Bihar & Orissa	..	2089

If we take foodgrains alone and take the decennial average of foodgrains available per capita per day for the period 1931-32 to 1940-41, we get the following figures:—

Madras	..	0.63	lbs.
Bombay	..	1.07	,,
Bengal	..	0.94	,,
Punjab	..	1.20	,,
U. P.	..	1.09	,,
C. P.	..	1.44	,,
Assam	..	1.04	,,
Bihar	..	1 30	,,
Sind	..	1.51	,,
Orissa	..	1.25	,,

food grains than they consumed, while Bengal and Madras were largely dependent upon outside regions for their supplies of rice and wheat. The production of sugar was concentrated in two provinces, viz., U.P. and Bihar, the rest of India being dependent on them for that vital food commodity.

Thus, from the point of view of food supplies, some parts of the country were surplus and others were deficit areas; and transport facilties formed the vital link between the two which kept the demand and supply of foodgrains in the country in a state of market equillibrium and prevented substantial differences in regional prices.

As regards raw materials, not only were domestic prices low, but demand was largely dependent on export markets. This was particularly true of commodities like jute, cotton, oilseeds, hides and skins, etc.,

Further, the technical efficiency of Indian agriculture was very low. The yields per acre of practically all the crops grown in India were below the corresponding yields in foreign countries, the difference being quite substantial. The quantity of chemical manure used by the Indian cultivator was practically negligible-this amounted

to a value of only Rs. 0.96 crore in 1938-39-and and was entirely obtained from foreign sources. As regards the possibilities of extension of the area under cultivation, the situation was not satisfactory. While, theoretically, the culturable waste available for extension amounted to 97.16 million acres, detailed inquiries had shown that of this vast area, only 10.04 million acres could be regarded as land practically useful for extending cultivation and that too after considerable capital expenditure.

To sum up the agricultural situation on the eve of the War, prices and agricultural incomes were abnormally low, while the burden of agricultural debt was very high. Raw materials were largely dependent on foreign markets, while food supplies were basically insufficient and so distributed that even market equillibrium could only be achieved partly by imports and partly by the inland movement of grains from surplus to deficit areas. The possibility of extending the area under cultivation was not very bright, while that of increasing yield by the use of artificial manure was dependent entirely on foreign sources. From the agricultural point of view, therefore, the country was unprepared for meeting the strain arising from either an external demand on its limited supplies or a fall in its foreign supplies of

food or a dimunition in its coastal and inland transport facilities ; while the chances of increasing domestic agricultural production depended almost entirely on the import of artificial manure from abroad.

The out break of war did not result in any relief to the cultivator. There was a speculative rise in agricultural prices immediately after the declaration of war. Taking the movement in the prices of eleven agricultural commodities* included in the Economic Adviser's Index, we find a rise of 45 points, from 100 in August 1939 to 145 in January 1940. This figure includes a much larger rise in the prices of articles like jute, cotton and copra and a smaller rise in the case of rice, sugar, tea, coffee and tobacco. But this tendency was soon arrested, partly by the failure of the anticipated war demand to materialise, partly by the loss of valuable export markets, especially for non-food crops, by Hitler's occupation of Europe, and partly by the inauguration of price control conferences by Government with its implied likelihood of a prevention of any rise in prices. Prices started falling, and the index of prices of the agricultural commodities

* These commodities were rice, wheat, tea, groundnuts, coffee, sugar, tobacco, copra, raw cotton, raw jute and linseed.

already referred to fell from 145 in January 1940 to 106 by August 1940 and kept near about that level till May 1941. The fall in prices was much sharper in the case of non-food crops than in that of food grains, the prices of the latter improving in fact after July 1940. Some idea of the relative price situation with respect to the different agricultural commodities during this period is given below :

Description		*August* 1939		*May* 1941
Rice	..	100	..	152
Wheat	..	100	..	140
Tea	..	100	..	not available.
Coffee	..	100	..	126
Groundnut	..	100	..	85
Sugar	..	100	..	91
Tobacco	..	100	..	47
Copra	..	100	..	109
Cotton	..	100	..	147
Jute, raw	..	100	..	100
Linseed	..	100	..	98

As as matter of fact, the position of some individual non-food crops had been even worse sometime before, though it had improved by May 1941. Thus e.g., raw cotton had fallen to 114 in February 1941, while jute had reached 86 in November 1940 as compared to the giddy height of 254 it had reached in December 1939. Till very nearly the end of the second year after

the declaration of war, therefore, agricultural prices had not recorded an appreciable advance and the cultivator had not improved his position. The position, however, was not static. Indian agriculture was gradually being exposed to the strain which we had already seen that it was not prepared for; demand for agricultural goods especially for food grains, grew apace both from overseas markets and from the Defence Department; tranport facilities, on which the internal market equillibrium of agricultural goods rested, were being rapidly curtailed; while the entry of Japan into the War and her conquest of Burma in April 1942 deprived India of a large overseas source of rice. At the same time, the increasing rupee expenditure incurred in India by His Majesty's Government from April 1941 led to the increase in total spending and inevitably reacted on the prices of agricultural commodities. Attempts at increasing the output of agricultural crops, especially of food grains, were made by Government by instituting a "Grow More Food" campaign; but this made hardly any material difference to the situation. Agricultural prices started rising from the middle of 1941, and the rise went on steadily. Abortive attempts at control of agricultural prices were made by Government, resulting in hoarding, local shortages and the emergence of black markets.

The rise in prices went on merrily, helped in its onward stride by the increasing tempo of the British Government's rupee expenditure in India and the grant of dearness allowances all over the country. The attempt at control of agricultural prices was finally given up by Government and agricultural prices moved up to 276 in March 1943 as compared to 100 in August 1939; and there seems still to be no end to this upward movement. In the meanwhile, Government have declared their firm intention not to control agricultural prices at their primary markets; and the general public is left wondering what the ultimate fate of their cost of living is going to be.

The cultivator, however, has gained from the situation. While it is true that a part of the rise has been intercepted by the middleman, and a part absorbed in paying for the higher prices of manufactured goods usually consumed by the cultivator, the fact remains that the real burden of his money obligations has diminished considerably. In particular, the real burden of agricultural debt has been substantially reduced by the rise in agricultural prices, and in many parts of the country, the cultivator is in a position to pay off the accumulated debts of several decades. Land values have soared up; and the

cultivator in general sees in his hands more ready cash to-day than he saw for a long time before. In fact, one may even describe the situation as a kind of boom in the agricultural industry. And there is no doubt that this fact has proved of considerable political value to Government in its attempts at maintaing its hold over the country during the recent disturbances.

But this agricultural prosperity is not without its disadvantage, even from the point of view of the cultivator. First of all, not all the cultivators have shared in the benefits of this rise in prices. A large number of cultivators possess such small holdings that they have hardly any surplus to sell; in fact they are in agriculture not for business but for getting a bare living. Such subsistence farmers could not have got much advantage from the rise in agricultural prices. Then there are the landless labourers who are, of course, even worse off and suffer the disadvantages of the rise in both agricultural and non-agricultural prices. It is only the bigger farmers who have gained the most from the war-time boom in Indian agriculture. Even they have not had unqualified gains. The monetary causes associated with this rise in agricultural prices have reacted in a similar manner also on the prices of manufactured commodities; and

the cultivator finds that the real value of his rupee is condsiderably less than what it used to be before the war. Cloth, kerosene and matches have all risen very much more in price and as, further, no cultivator grows everything he consumes, he also feels the pinch of rising agricultural prices. He finds that the rise in the prices of the things he sells is accompanied and followed by a rise in the prices of the things he buys, and he is no better off than before as far as real purchasing power is concerned. In fact, the usual thing he spends on when he is feeling rich with money viz., gold and silver are not readily available and by competing with his neighbour for its possession, he is pushing up their prices to a level much above that to which the prices of his own crops have have risen. The most sensible thing for him to do would be to pay off his money obligations ; to repurchase the debt that he has incurred or taken the responsibility for in the past. That is the only thing the price of which has not gone up ; and is therefore the most profitable thing for the cultivator to spend his money on. It is likely that the creditor would be found only too willing to let the debt stand and in fact avoid receiving payment. But the cultivator should, in his own interest, take this opportunity of reducing or wiping out his debt.

Whether he is doing so or not is not known with certainty. But Government could have done a great deal towards helping him to do so by an acceleration of the process of debt conciliation and by forming debt conciliation boards wherever they did not exist. This would also have indirectly helped investment in war loans, as the money lenders could not easily have found another profitable source of investment for the funds now re-acquired by them. But so far no such action has been taken by Government; and the cultivator is largely wasting his new increments of cash income by buying at inflated prices gold and silver and manufactured articles that are likely to depreciate in value at the end of the war. The cultivator must also realise that the present rise in his prices is largely abnormal and that it is bound to be followed sooner or later by a fall. The wise thing for him to do therefore would be not only to reduce or wipe out his money obligations incurred when the real value of money was higher, but also to avoid incurring new money obligations at present and at the same time build up a reserve for the rainy day. These are the lines on which the cultivator should be induced to frame his economic conduct during the war; but there seems to be no indication that Government is doing so.

While the present agricultural boom contains dangers even from the cultivator's point of view, it is much more so from the point of view of the general public as also of the war effort. The steadily rising prices of agricultural goods, especially of food grains, has led to a steep rise in the cost of living; this in turn has led to the grant of dearness allowances on a large scale and therefore to more rises in the prices of both primary and manufactured commodities. In turn, this leads to an increased money expenditure for financing the purchasing of the same quantum of goods and services needed for the war effort by both the British and Indian Governments; this leads to a greater volume of rupee expenditure by Government and therefore stimulates a further rise in prices. The rise in agricultural prices is thus definitely playing a significant part in maintaining the inflationary spiral and this is certainly not to the permanent advantage of any interest in the country.

The reasons for this remarkable rise in agricultural prices have been briefly indicated already and will be discussed in further detail in a subsequent chapter on the general rise of prices in India. But the peculiar feature of the agricultural situation was that not only did prices rise but it was difficult to get supplies

even at the higher prices at many centres, the traders either having no stocks or denying that they had any; and secondly, there were wide and sometimes fantastic variations in the agricultural prices prevalent at different areas. The main reason for this significant difference between agricultural and non-agricultural prices was the ill-planned attempt of Government to control the prices of agricultural commodities by fixing legal maxima; this led to the creation of a hoarding psychology in both the farmer and the trader and led to the emergence of black markets; the process was also aided by the difficulty of obtaining transport, and, even more, by the unco-ordinated and arbitrary orders passed by the provincial and States Governments—sometimes even by district officials—prohibiting the free inward and outward movement of food grains from their respective areas. This led to acute physical shortages in some places and stimulated a hoarding mentality also in the middle class comsumers; while it was mainly responsible for the large variations in agricultural prices in different regions. Government have now dropped their attempt at price control; but this has only resulted in giving a legal form to the high prices formerly having an illegal, though active existence, in the black markets; and

shortages, particularly in food grains of good quality, still prevail in many areas in the deficit provinces largely because of transport difficulties.

The problem of high agricultural prices, especially of food grains, is now becoming very acute, and Government is being clearly exercised over the same. Their latest attempt at dealing with the question has taken the form of the creation of a separate Food Department of the Government of India with a view to centralising the problem by control of surplus stocks and their movement into deficit areas. In a broadcast given from the Delhi Radio Station, General Wood, Secretary to the Food Depar ment, laid down the following fundamentals of Government policy - -

(1) The Food Department is to procure all surplus food grains and make a proper distribution of the same between the provinces and States that need them. The provinces and States will then ensure proper distribution within their own areas.

(2) The Central Government will purchase the surplus food grains through the agency of the provincial and States Governments; and the purchase will be by

normal commercial methods by paying a fair price and not by any system of controls.

(3) The surplus food grains will be sold at prices related to what has been paid for them, and to ensure that they do not disappear into hoards or black markets, the agency of supervised grain shops will be used assisted by rationing in the cities.

(4) Definite attempts will be made to eradicate hoarding by vigorously proceeding against the big hoarders and by using Government stores of food grains to bring down prices wherever they have been artificially forced up by private cornering.

General Wood coneluded by saying that "there is enough for all. There is even a bit left over. The plan is laid to apportion this sufficiency for twelve months."

The plan sounds good; but depends for its sucess, administrative efficiency apart, almost entirely on the estimates of provincial surpluses and deficits proving right, and the current year's harvests coming upto expectations. Moreover, it is also essential that overseas demand and military requirements are not permitted to entrench

upon the domestic supplies already curtailed by the cessation of imports of Burma rice. Then again, as long as Government's rupee expenditure both on its own account and on that of the British Government proceeds at its present rate and is financed by the issue of new paper currency and is not offset by effective freezing of the additional purchasing power thus accruing to the people, prices are bound to rise; and rising prices against this background will have the inevitable effect of making the cultivator feel that prices will rise still further, and this will induce him to hold up stocks, more particularly as his cash requirements can be met by the sale of a smaller proportion of his output than before. And once the cultivator begins to hoard, it will be difficult for Government to carry out their plans for purchase of food grains. As Government have now assumed direct responsibility for feeding the deficit areas, the consequences of failure will be even more serious than when the trader and the *bania* could be charged with being the cause of the food trouble.

In order to see that the maximum amount of food grains is made available for securing the needs of the deficit provinces, Government must not only see that the cultivator puts on the market the same proportion of his output as he used to

do berore, but also that his output as a whole is increased, and further that it is not subjected to the pressure of overseas and military demands. Government have been trying to stimulate the output of food grains by a "Grow more Food" campaign, but it is difficult to estimate the results of the same in the absence of reliable statistical data. Official statistics of area and yield of the two major food-grains *viz* rice and wheat are given below for what they are worth.

(Area in millions of acres.)

	1939-40	1940-41	1941-42	1942-43
Rice ..	74.3	72.2	73.6	74.9
Wheat ..	34.0	34.8	34.0	34.1

(Yield, in millions of tons.)

	1939-40	1940-41	1941-42	1942-43
Rice ..	25.8	21.9	25.4	24.5
Wheat ..	10.8	10.0	10.1	10.9

It will be seen therefore that there has been no substantial improvement in domestic supplies; coupled with that is the loss of about 1.5 million tons of rice hitherto imported from Burma; in addition, there is the millitary demand amounting in General Wood's words to .3% of rice supplies and 2.5% wheat supplies. It must be remembered however that the strain of military demand must fall mainly on that part of the cultivator's output which is placed on the market and if this

is taken as one-third or 33-1/3% in the case of food grains, the incidence of military demand on the actually available market supplies is much greater than the figures mentioned by General Wood, and will amount to .9% in the case of rice and 7.5% in the case of wheat. There is in addition overseas demand and purchases by the U.K.C.C. for supplying to the markets in the near East and the Middle East for which no information is available. Altogether therefore, the situation is not satisfactory from the point of view of total supplies; and market supplies will turn almost entirely on Government's ability to induce the cultivator to place on the market his normal quota of output.

Apart from securing adequate supplies, Government has also the task of seeing that the available supplies are equitably distributed over the different regions. This is not likely to be served without adequate transport facilities. Such facilities do not seem to have been made available so far, if one may judge, e.g, from the difficulties being experienced regarding sugar in in so many places, in spite of the public claims of the Sugar Controller that adequate quantities of sugar are available in the country and that exports of sugar are practically negligible. In addition to transport facilities, a comprehensive

and efficient scheme of rationing in all the urban areas in the country is necessary to ensure that the supplies available in each province are distributed equitably and not determined by the mere possession of monetary purchasing power. So far, rationing has been undertaken only in a few cities; and wherever it has been instituted as in Bombay City, Bangalore, etc., after some initial difficulties, it is being attended with a fair measure of success. *Ad hoc* arrangements are also being undertaken by some large employers, like Railways, Government, and certain industrial magnates to supply their workers necessary food grains by securing supplies and distributing them on the basis of coupons. But there is no rationing in most of the urban areas and the vast majority of the urban population is finding difficulty in getting supplies and have to pay prices as high as 3 or 4 times the pre-war rates to obtain the quantities they require; and money power is proving a vital factor in determining the distribution among urban families of the reduced quantities of food now available to the urban areas. Calcutta is an outstanding illustration of what short supply accompanied by the absence of rationing can produce by way of difficulties for the consumer.

If the food problem is to be effectively

and efficiently handled by the Government of India, six things are necessary:

(1) The total supply of food grains in the country must be increased not only to the pre-war level but to some extent at least above that level. This cannot be done merely by an attempt at diverting the area under cultivation from non-food to food crops by either a "Grow More Food" campaign or by artificially depressing the prices of non-food crops like cotton. The area under non-food crops in 1938-39 was only 29 million acres as compared to 213 millions under food crops; and scope for diversion is not very considerable. Even to the extent that it is possible, it can be brought about only by a well planned system of subsidising a diversion in acreage from non-food to food crops in selected areas on the lines of the American A.A.A. system and not by trying to depress non-food prices or guarantee in vague terms minimum food prices. As for increasing the acreage unde food by increasing the total area under cultivation that is not an immediately practicable pro-

position. Increase of irrigation facilities-for effecting which Government have employed a special expert in recent months-is again a long range remedy and cannot solve the immediate problem of increasing food supplies. Imports from abroad are dependent upon the shipping position, but even if they are possible on a large scale, they apply only to wheat and cannot remedy the rice shortage which is so much more acute at present. The only practical way of quickly increasing yield is the use of artificial manure; it is true that we do not produce chemical manure in this country, but it can obtained from the United States and should be given priority, in view of the interest of the United Nations in maintaining India as a granary. If this is not possible for various reasons, the only alternative is to prohibit all exports of food grains from this country; if the United Nations have a military interest in the feeding of the countries in the Near East and the Middle East* it is their

* This seems to be the position taken up by the *Economist* in one of its recent issues.

duty to provide India with the chemical manure with which she can increase her domestic output of food grains and thus meet the increased demand on her diminished resouces** Care must also be taken to see that vigorous economy is exercised on the food requirements of the defence services and that all waste is eliminated in this respect. It would be reassuring to the public, if Government were to take the country into its confidence and let them know the total food grains purchased by them so far and the number of persons whose needs this is supposed to meet. In any case, real relief is not possible unless the total quantum of food grains available to the civilian population is at least equal to the pre-war level.

** One cannot help pointing out at this stage that if only the Government of India had helped to establish a heavy chemical industry in the country in the pre-war decade, it would have been easy to have utilised India's agricultural potential and obtained the required increase in its output of food grains. This is only one more instance of how the lack of a forward industrial policy on the part of the Government of India in the past has led to the present inability of the Indian economic system to face the strain of War economy.

(2) Even more important than increasing the output of food grains in the country is the need for seeing that as large a portion as possible of the output is placed on the market. To achieve this, it is necessary to prevent hoarding both by the cultivator and the trader. This cannot be done merely by propaganda. While vigorous penal action by Government against hoarders will help, it does not go to the root of the problem. *The root cause of hoarding is rising prices; hoarding accelerates the prcess but is itself the result of rising prices.* As long as the rise continues, both the cultivator and the trader will feel that prices will rise still higher and will be induced to hoard; as long as prices continue rising the cultivator's cash requirements for taxes and interest will be met by the sale of a smaller and smaller proportion of his output; and he may therefore be tempted to hold back a larger part of his output. The rise in pıices must therefore be stopped if the food question is to be effectively tackled by Government. But it cannot be

stopped by any blanket measures of price control. No amount of direct contról of agricultural prices without controlling the volume of spending is going to succeed; if the total purchasing power in the country is being continually increased, it is bound to lead to a rise in prices of manufactured goods and therefore of agricultural goods, of agricultural goods and therefore of manufactured goods, and so on, in an inflationary spiral. Government has realised the futility of price control and has therefore dropped it; but they have not realised the fact that the primary cause of this failure was the continuous increase of rupee purchasing power in the country without a corresponding increase in consumption goods. As long as that cause remains, Government's new food policy is also unlikely to succeed; they will find that owing to the reasons already mentioned, the cultivator will place on the market a continuously smaller proportion of his output and the increased purchasing power impinging upon this diminished supply of food grains will

lead to a further rise in agricultural prices, therefore of industrial prices and of wages, therefore of the rupee finance required by Government and so on. It is essential therefore that either the rupee expenditure incurred by Government on its own behalf and on behalf of the British Government should diminish or that effective steps be taken to freeze the increased purchasing power and prevent it from reacting on the market for consumable goods. Without this being done, it will be difficult for Government to solve the food problem.

(3) The third important condition is the provision of adequate transport facilities for the movement of food grains. Without such facilities, neither an increase in total output nor in the proportion of output placed on the market will solve the problem. In view of the difficulties of obtaining transport, Government should adopt a twofold policy regarding transport in relation to agriculture. On the one hand movement of food grains should be rationalised by dividing the country into

self-sufficient regions, these regions being constituted irrespective of provincial and States boundaries; on the other hand, particular attempts should be made to increase the acreage under food and yield per acre in the deficit districts and in areas difficult of easy access by rail transport.

(4) The fourth important condition for the successful tackling of the food problem is the institution of a proper administrative machinery for its execution. The creation of a separate Food Department of the Government of India is a step in the right direction; but unless it is followed by centralised control and regulation of food movements all over the country, it will not achieve its purpose. It does not appear however that this centralised control has been achieved so far. Provincial and States Governments still continue to have their own food policies and issue orders, presumably on their own, prohibiting the free movement of food grains. Moreover, the provincial Governments have been entrusted by the Government of India with the task of acting as their purchas-

ing agents in surplus areas. In the absence of adequate central machinery the deficit areas are likely to exaggerate their requirements while the surplus areas will underestimate their surpluses ; and the absence of an efficient statistical service relating to agriculture makes the task of central checking up of the provincial claims exceedingly difficult. Constitutional difficulties arising from provincial autonomy are causing difficulties in the way of control and there is trouble even from the provinces where provincial autonomy is suspended and there are Advisers' administrations. The Government of India have ample powers under the Defence of India Rules and unless these powers are exercised with the same vigour wlth which they have been exercised in the political sphere, it will be difficult to administer any centrally-planned food policy.

(5) The fifth condition for a successful food policy is the setting up of an appropriate machinery for ensuring the efficient distribution of food grains within the provincial areas, irrespective of their being either surplus or deficit areas. This

requires the institution of rationing in all principal urban centres; but so far this has been undertaken only in a few places. The whole task of distribution, even given the necessary supplies, is truly gigantic and will demand the subordination of provincial interests to the nation's and the willing and whole-hearted co-operation of the public. Both these would have been much easier with a national government at the centre; and both have become much more difficult with the continuation of bureaucratic rule at the centre and the existence of miscellaneous governments in the provinces unlinked by any common party or national interest. Whether this is going to prove an insuperable obstacle to the successful tackling of the food problem is a subject on which no dogmatic opinion can be expressed, but it has certainly made it more difficult of solution.

(6) Finally, it is necessary that the increased purchasing power now finding its way into the hands of the cultivator as a result of rising prices should be utilised not in spending but on the reduction or liquidation of his agricultural debt. If

this is done, the cultivator will get the best return for his increased money income; and at the same time, his increased spending power will not result in an increase in the prices of manufactured goods and will not therefore give a fillip to the inflationary tendency in the country. It would also be easy for Government to induce the moneylender to invest his newly-recovered credits in Government bonds; in any case, the moneylender is far less likely to spend on current goods his increased money power which he would regard as his capital than would the cultivator who would regard it as an increment to his income. To achieve this object, Government should first of all inaugurate a vigorous "Repay your debts" campaign among the cultivators, pointing out to them the mainfold disadvantages of spending their increased income on on highly-priced manufactured articles and the great advantage of dicharging a larger real volume of debt by paying a smaller real volume of purchasing power, even though it may not seem so in terms of mere money. In addition

to this propaganda, Government should also provide on a large scale the necessary machinery for debt conciliation and the speedy determination of moneys due from cultivators to the money-lenders. The services of the Co-operative Movement could also be profitably utilised in this conection. Simultaneously a compaign may also be started for inducing money lenders to take this opportunity of recovering their debts, and offering them special terms for the reinvestment of such funds in Government loans. If this is done, it will not only help the cultivator to get the most lasting advantage out of the temporary boom in this industry, but also help to arrest the rising trend in general prices and thus make easier the handling of the food problem in the country.

To sum up, the effect of the war on Indian agriculture has heen, on the whole, to the cultivator's advantage, especially for the bigger farmer. His money income has increased, while his money obligations in terms of taxes and debt have not gone up; as against this, the prices he has to

pay for non-agricultural goods have also gone up, but this has not been sufficient to offset the advantage arising from the two factors mentioned above. In fact one may say that the war has led to the emergence of boom conditions in Indian agriculture. The best way of capitalising the results of the boom from the cultivator's standpoint would be to induce him to utilise it for repaying his debt and this would also prove to be in the best interests of the nation as a whole.

The boom, however, has not proved of equal benefit to the country, nor even to a vast mass of the rural population, who belong to the class of landless labourers or subsistence farmers. The high prices of agricultural goods is resulting in a steady rise in the cost of living, and thereby giving a fillip to the inflationary tendency in the country; at the same time it is associated with a physical shortage of food grains for the civilian population which is having painful consequences especially in the urban areas. The rising prices has not led to an increase in production and the price boom is beginning to feed on itself. The remedy is two-fold; on the one hand, Government should undertake a vigorous short period programme for increasing the

output of food grains and making it available to the civilian population; and this can best be done by obtaining artificial manure from abroad and placing it at the disposal of the cultivators while simultaneously vigorously curtailing exports and subjecting distribution to rationing in the urban areas; on the other hand, Government should take steps either to reduce their volume of rupee expenditure or get frozen the consequent increment to the people's purchasing power. The food problem thus proves to be only a part of the general problem of scarcity and inflation, and a background of political disassociation with the people which is so characteristic of India' war economy and of which more will be said in subsequent pages.

CHAPTER VI.

THE WAR AND INDIAN INDUSTRY

The industrial position of India on the eve of the war has already been briefly indicated in Chapter II. The principal industries in existence were cotton textiles, woollen textiles, jute textiles, sugar, iron and steel, matches, paper, cement, sulphate of ammonia and sulphuric acid, and the plantation industries of tea and coffee. The position regarding production is shown in the following figures pertaining to the year immediately preceeding the outbreak of war viz. 1938-1939.

Description.	Unit.	Quantity.
Cotton manufactures ..	(Million lbs.)	920.5
(Cotton piecegoods ..	(Million yards)	4269.3)
Jute manufactures ..	(000) Tons.	1221.5
Wheat flour ..	(000) Maunds.	16482.5
Paper ..	(000) Cwt.	1183.9
Sugar ..	(000) Cwt.	13404.
Matches ..	(Millions) Gross.	21.1
Sulphuric acid ..	(000) Cwt.	511.7
Sulphate of ammonia ..	(000) Tons.	14.9
Pig iron ..	(000) Tons.	1575.6
Steel ingots ..	(000) Tons.	977.4
Finished steel ..	(000) Tons.	725.7
Kerosene ..	Million-Gallons.	38.7
Petrol ..	,, ,,	19.8
Coal ..	,, Tons. (Calendar year 1938)	28.3
Paints ..	(000) Cwt.	577.3
Products of distilleries and Breweries ..	Million-L.P. Gallons.	10.6

The industrial position was however different from the agricultural position with regard to the immediate effects of the impact of war; with the exception of tea and jute, Indian industry was mainly catering for the domestic market. In the case of tea, Britain was the chief customer, while in jute, any possible fall in demand due to the loss of enemy export markets was likely to be offset by the increase in Allied demand due to war requirements. The markets for the products of Indian industry were thus mainly located either in Allied or in domestic territory. The outbreak of war therefore was not likely to cause any such decline in demand as took place in the case of some agricultural commodities like tobacco, groundnuts, and raw hides and skins. On the other hand the industrial outlook was similar to the agricultural outlook in respect of the difficulties of increasing output, for the basic industries which determine the industrial potential of a country were conspicuously absent in India. Thus the country did not possess either the heavy engineering or the heavy chemical industry nor the resources of skilled labour and technicians that go with these industries. This was bound to cause inelasticity in the supply of industrial output. The possibilities of increasing output were therefore dependent on

the imports of machinery, machine tools and spare parts and as these could not be obtained from enemy countries, it meant that the industrial potential of India was largely dependent on the chances of obtaining imports of capital goods from the Allied Countries sufficient to build up the heavy industries in war-time India. At the same time the war was bound to cause a heavy demand on India's industrial potentialities. Munitions production had to be expanded several fold, and large quantities of civilian industrial goods had to be provided for military purposes. There was also the strain caused by the reduction and in some cases complete cessation in imported manufactures with the consequent demand for replacing them by domestic substitutes. There was also the pressure of civilian overseas demand for Indian manufactures from neighbouring allied theatres of war. All this called for an enormous increase in the industrial capacity of the nation; and that could be attained only by a deliberate policy of encouraging the immediate establishment of the heavy industries in India. Failure to do this was bound to lead to scarcity and shortages of manufactured goods and therefore to a spell of rising prices. In actual fact, this was exactly what happened in India.

As far as munitions production was concerned, Government set out vigorously to increase the output. The background had been previously prepared by a departmental committee of the Army Head Quarters of the Government of India which had conducted a number of detailed inquiries and on this basis an ad hoc committee had made recommendations for the creation of a Supply Organisation to tackle the problem. The result was that with the outbreak of war, a Supply Department was brought into existence and combined with the Commerce portfolio* ; the department had two Directorates General, one in charge of Munitions in the widest sense including practically everything made of metal reqired by the Defence Services ; and the other in charge of the remaining miscellaneous stores such as cotton and woollen textiles, leather, food, clothing, timber, chemicals and other stores. The munitions branch of industrial production was materially assisted by the programme chalked out by the Chatfield Committee for the expansion and

* This was a definite improvement over the last war, when it had taken two years to bring the Indian Munitions Board into existence. The scope of the Supply Department was also larger and included production in addition to purchase—G. Tyson " India Arms for victory " pp. 18-21.

modernisation of existing ordnance factories and the setting up of additional establishments for the manufacture of high explosives. This was followed by the visit of the British Ministry of Supply or the Roger Mission in 1940 which had as its main function the exploring of other means of munitions production such as by Railway workshops and private industrial establishments. This was followed by the estatablishment of the Eastern Group Supply Council. Then came the institution of lease-lend and the visit of the American Technical or Grady Mission to this country for the purpose of further exploring India's possibilities in the direction of munitions production and the manner in which this could be assisted by American supplies of machinery, machine tools etc. The great difficulty of course has been the absence of an independent engineering industry in the country, and the dearth of skilled technical labour. Government inaugurated schemes for technical training and by October 1942, 15,000 men had passed through the technical training institutions, while another 35,000 were under training.** Government also resorted on a large scale to the

** The number of similar new technically trained personnel in Australia with its very much smaller population was more than 70,000.

engineering talent of the Railways and made full use of Railway workshops, even though this was at the expense of the efficient maintenance of transport facilities which was also an important military requirement. Private industry also rose to the occasion and in the words of Mr. Tyson, "Armour piercing steel, steel for machine tools and wheels and axles are key items in a long list of things that derive from Tatas and which are of sovereign importance for victory."* The Tinplate Company of India is another concern that contributed its quota to meeting war supplies, while the Metal Box Company of India increased its labour force by more than 160% and produced in large quantities metal items like anti-tank mines, ammunition case linings, baking tins, emergency ration tins, mess tins, insecticide sprays etc. The Indian Standard Wagon Company whose normal work was manufacture and repair of railway rolling stock turned its attention towards the manufacture of waggons for military purposes and shell forgings, drop-forgings and fittings for armoured vehicles: but it must be noted that all

* Ibid. pp. 62-63. For a long list of other things produced at Tatanagar, see p. 68 et seq. I am generally indebted to Mr. Tyson's readable and careful study of Indian war production for the factual part of this chapter.

this activity entailed a reduction in the output of waggons for transport purposes. As compared to the number of trade workshops which stood at 600 before the war, the Director of Munitions Production is now using 1500 engineering workshops, 840 for general engineering items, 300 for small tools and 345 plus 23 Railway Workshops for munitions components: while in addition a very large number of small manufacturers are employed as sub-contractors. In fact, it is stated officially that 'India now makes 90% of the various articles required by the Army ; * The expansion has been enormous both in kind and and in quantity: and the position regarding production of munitions and other goods required by by the defence personnel has been quite satisfactory.

But a good deal of this increased production was at the expense of civilian supplies : ** and the consequent reduction in the supply of manu-

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* Vide, Indian information vol. 12 No. III, p. 202.

** Thus, e.g. 80% of India's steel production is taken up for direct Defence needs and the needs of essential services such as Railways the balance being issued for civil needs classed as essential. Indian cotton mills have set apart 35% of their total production for the Supply Department, while in the case of woollen textiles 100% of the mills capacity is being used by Government. Recently control has also been imposed upon cement, 90% of the output going to direct Defence. Among other articles controlled may be mentioned rubber, vehicles paper, etc.

factured goods available for civilian consumption was further accentuated by the dimunition in imports and increase in exports of manufactured goods, to which reference has already been made in a previous chapter. The net result of all this was the emergence of a serious shortage of manufactured goods with respect to civilian demand : and this resulted in pushing up the prices of industrial products. It is needless to add that this process was also aided by the increasing expansion of currency and purchasing power resulting from the rupee expenditure of the British Goverment in India.

Strangely enough no attempt was made by Government to control the prices of industrial products or arrange for an equitable distribution of stocks of manufactures the imports of which had declined or even disappeared altogether. Prices shot up, particularly in such items as dyes, starch and other mill stores, and stockists made large profits, the net result of which was to add one more factor for pushing up the prices of textile manufactures. If control had been exercised right from the outbreak of war on the imported and indigeneous goods used for the purposes of industrial manufacture, one significant cause for the rise in industrial prices, particularly of textile goods would have been eliminated. Lack of con-

trol has led to high prices and great difficulties in obtaining supplies of such articles like drugs, medicines, electrical bulbs and other electrical goods, hardware, crockery and porcelain goods, and a number of imported articles formerly in common use among the civilian population. Control would have been far easier in the case of the imported articles, and if control of industrial prices had been instituted right at the commencement of the war, and made effective by rationing of the reduced supplies, an important cause of the rise in the cost of living in urban areas would have been avoided, and to that extent, it would have limited the inflationary tendency in the country. In fact, the passive attitude of Government towards the rise in the prices of industrial goods as contrasted to their attempts (abortive though it proved to be) at controlling the prices of agricultural goods makes one wonder if their attitude was influenced by the fact that in the former case, they shared in the excess profits, while in the latter case, they did not. Perhaps, Government was also actuated by the desire not to offend powerful industrial interests at a time when they were already at loggerheads with the leading political party in the country and could not be said to enjoy much active support from the people. Appeals to patriotism which succeeded in the other bellige-

rent countries where Government and people were one could not work in India; and the money incentive had to be employed on a large scale. This was perhaps the reason why no ceilings were placed on prices and wages; why grants of dearness allowances were actually encouraged by Government, and why the rate of excess profits duty was left to remain at $66\frac{1}{3}\%$, though it had been put up to 100% in England and many of the Dominions. The political factor was also evidently having its share in adding to the economic malady. Whether this explanation is correct or not and whatever be the motive that influenced Government's policy of non-control over industrial prices the fact remains that owing to the factors already mentioned, there was a serious shortage of manufactures—both domestic and imported—in India; and if it was not to result in a rise in prices and in the cost of living and the volume of rupee finance required by Government, it was essential that control should have been instituted over industrial goods, and wage and price ceilings and rationing introduced at an early stage of the war. The failure to do so is one of the major cause of the rise of prices in India and constitutes part of the explanation behind the inflationary trend about which we say more in a subsequent chapter. But the truth behind this contention is best illustrated by the

example of cloth, where prices went up to nearly 400% of their pre-war levels and were directly linked up with scarcity and the absence of control.

The problem of scarcity could also have been tackled by increasing production; and while Government did succeed in substantially increasing the output of munitions and of goods intended specifically for military use, they failed to increase the output of civilian supplies; and in fact had to reduce it. In other words, total industrial capacity in the country was increased very much less than industrial capacity used for military purposes. This would have been bad enough, even if it was inevitable; but in the case of India, it was not inevitable. India's industrial potentialities are immense and, given the basic equipment provided by the heavy engineering and heavy chemical industries, she could have met all the needs imposed on her by the war and more without having to reduce the supplies of industrial goods available for civilian consumption. We have already seen how the absence of these industries resulted in a limitatiion of transport facilities and thereby threw out of gear the economic machinery of production and distribution in the country; we have also seen how they also prevented the much needed increase in the output of food grains

which could have been secured by the use of artificial manure on a large scale in selected localities. In the realm of industry, the difficulty of obtaining spare parts, machine tools and machinery for addition and replacement made for sharp limitations in supply and led to high prices which, neverthless, could not induce increased production. The Government of India cannot escape the responsibility for this situation resulting from the lukewarm industrial policy they had followed in the pre-war decades. Mr. Tyson's defence * that India was unprepared for war just like the rest of the British Empire and cannot therefore be assigned any special blame cannot absolve Government from the fact that they had taken no action in spite of the repeated demand from the people for the establishment of heavy chemical and heavy engineering industries for years before the war. Reservation of coastal shipping and manufacture of locomotives are but two well known instances of the lukewarm attitude displayed by the Government of India towards the development of the capital goods industries in the country, and it cannot be denied that India's industrial contribution towards the war would have been far greater if she had possessed capital goods industries, with

* Ibid. pp. 8-10.

the additional advantage that there would have been no scarcity of industrial goods for the civilian together with its inflationary consequences.

The tragedy of the situation is that not only did Government follow such a short-sighted policy before the war, but continued to do so even afterwards. Instead of regarding the establishment of the heavy industries in India as a major war interest and facilitating the obtaining of machinery for this purpose from abroad, they persisted in their attitude of half-hearted sympathy, if not one of active indifference. The history of the proposal to establish an automobile industry in this country and its reception at the hands of the Government of India is too well known for detailed discussion. The manufacture of locomotives in India has now been relegated to the post-war period while neither a ship-building nor an aeroplane industry has been brought into existence in the country. Today, it cannot be said that the Indian Government has taken such advantage of the industrial opportunities offered by this war as the Dominions have done; and the effect of this war has not been to make such fundamental additions to Indian industrial capacity as was the case during the last war.

The example of Australia is a study in con-

trast, as far as addition to industrial capacity is concerned. New fabrication works for the manufacture of aluminium alloy sheets have been set up in that country: and Australian bauxite is being used for the purpose of making ingot aluminium. Aero-engines of various types are being manufactured in Australia and that Dominion now possesses an air-craft industry producing bombers and fighters on a mass basis. She has also built up a big ship-building industry and is talking of possessing her own mercantile marine at the end of the war. Among other industries brought into existence with Government help may be mentioned cotton textiles, optical glass, radio equipment, power alchohol, heavy paper, tanks, match chemicals, nitric acid, methanol, potash and high explosives. The actual output of the country has been more than doubled, and the end of this war will see Australia a far more powerfully industrialised nation than she was at the outbreak of war.

In fairness however, it must be admitted that some additions have been made to India's industrial capacity during the war, even though not all of them are due to the stimulus of war and some have actually been delayed on account of war-time restrictions on imports. Examples of the latter would be the chemical and alumi-

nium plants just coming into operation in the country. But among war-induced additions to Indian industry, apart from munitions and defence materials, should be mentioned the expansion in the output of steel, manufacture of specialised types of steels, increase in the output of silk filatures and of amonium sulphate and sulphuric acid and of paper, and manufacture of some types of electrical goods, canned goods, medical instruments, and a number of drugs and dressings formerly imported from abroad. ∞

Perhaps the most impressive achievement of the war in the industrial field has been the establishment of the Board of Scientific and Industrial Research under distinguished direction of Sir Shanti Swarup Bhatnagar. To state a few of the research tasks on which the Board has been engaged may be mentioned the use of vegetable oils as lubricants, preparation of plastic materials chiefly from materials available within the country, economic disposal of molasses, manufacture of sulphur, preparation of dyestuffs, particularly dyestuffs from vegetable products, manufacture of certain drugs, investigation of the possibilities of making scientific

∞ Statistics of output are available only for a few industries and are given on the next page.

instuments, work in regard to metals and alloys,

Description.	Unit.	1938-39	1939-40	1940-41	1941-42	1942-43 (1st 7 months)
Cotton manufactures (excluding twist and yarn)	(Million lbs.)	920.5	877.8	981.4	1093.5	579.7
(Cotton piece-goods)	(Million yards)	4269.5	4012.5	4269.4	4493.5	2239.7
Jute manufactures	000s Tons.	1221.5	1276.9	1108.2	1258.8	596.9
Wheat flour	000s Maunds.	16482.5	16157.7	16676.8	18105.5	7745.7
Paper	000s Cwt.	1183.9	1396.9	1753.1	1870.9	762.5
Sugar∞	000s Cwt.	13404	25902	23567	18338	23000
Matches	Millions Gross.	21.1	22.0	23.1	16.5	—

Source-Monthly Survey of Business Conditions in India.

∞ The figures are estimates for 1941-42 and 1942-1943 and takes into account all the 12 months in the latter year.

research regarding glasses and refractories, investigating the possibility of manufacturing internal combustion engines in this country and manufacture of graphite and carbon electrodes. The Board has done what are those useful work in providing substitutes and there is no doubt that it would have been of much greater service to Indian industry but for the exigencies imposed by the war.

While this record of the effect of war on Indian industry makes good reading, it must be repeated that the main effect of the war has been much more in the direction of the development of munitions, war material and ordnance factories than in that of industries which are likely to prove of use to the civilian population at the end of the war; and further, the vast increase which has taken place in munitions and allied output has been largely at the expense of the output of civilian goods. It may be said that there is nothing extraordinary in the latter fact and that the same thing has happened in the other belligerent countries. But there is a vital difference in this respect between India and the other belligerent countries. India's pre-war production of industrial goods combined with her imports of the same was not even sufficient for her bare requirements

and contained no margin that could be diverted for non-civilian purposes ; her industrial potential or capacity for increasing production was very low largely as a result of Government's failing to adopt a forward industrial policy ; at the same time, given the establishment of the heavy industries in the country, the possibilities of increasing industrial production of both capital and consumption goods were immense. Hence the obviously correct thing for the Indian Government was not to aim at an organization of industry that merely meant a diversion from civilian to military production but an organization that would remove the gaps in the industrial structure, eliminate the bottlenecks and increase the total industrial capacity of the country. Government's failure to do this has resulted in an acute scarcity of manufactured goods available for civilian consumption in India and thus added a powerful factor for reinforcing the inflationary tendency in the country.

There was another way of meeting, at least to a limited extent, the problem of scarcity of industrial goods ; and this was to increase production by organising India's small scale and cottage industries. This could have been done without the establishment of heavy industries or the import of machinery on

a large scale for which Government was not prepared, either out of inability or of unwillingness. In fact, it was by reorganising her small scale and cottage industries that China was able to face the problems created by the seizure of her organised industries by Japan ; and the success of the Industrial Co-operative Movement in China is not subject to controversy. Government of course did try to get the aid of small industry and it is stated that orders reached a total value of Rs. 5 crores in 1941-42 and are expected to reach Rs. 10 crores in 1942-43 ; but the main items in which artisan help has been secured is in the supply of Government and military stores like camouflage nets, pith hats, cutlery, blankets, and dosuti or double yarn used for making tents or bandage cloth. Even here, Government supplies have been, in certain directions, at the expense of civilian supplies ; and no attempt was made to bring about that substantial increase in productive capacity which could have been possible on the basis of a well-planned and popularly-supported drive for the mobilisation of cottage and small scale industries. In particular, no advantage was taken of the All India Spinners' Association and the All India Village Industries Association which possessed considerable experience in this

matter and could have been of immense use in increasing the output of civilian goods by cottage industries, especially of cloth which was in such a serious state of shortage

There was another, though less satisfactory, way of meeting this problem which also Government failed to adopt. That was to prevent the scarcity of manufactured goods from having an inflationary effect by instituting control over industrial prices and rationing the limited supplies in order to secure an equitable distribution of the same and also ensure the effective execution of the price control policy. What Government did however was to obtain the supplies it required by a liberal use of rupee finance on the one hand and priority controls on the other, leaving the resultant scarcity of civilian goods to the market forces of monetary demand. This no doubt resulted in the emergence of boom conditions in Indian industry; share prices went up, profits touched record levels, Government got a large revenue by way of excess profits tax, and industrial workers got substantial dearness allowances. But it also meant untold suffering for the large masses of the people, particularly for the middle classes in the urban areas and the agricultural proletariat in the rural areas; it meant an increase in the

volume of rupee finance required by Government both for its own purchases and for those of the British Government, and therefore the creation of additional purchasing power; and by increasing the money incomes of industrialists, merchants, traders, and industrial workers, it gave further support to the inflationary tendency caused by Government's increasing expenditure. The country is paying a heavy price for the industrial boom which has been generated on account of the war.

At long last, however, Government has realised the importance of civil supplies in war economy. They have now set up a Department of Industries and Civil Supplies; and control is being imposed on the cotton textile industry for civilian purposes. But this is being done in the fourth year of the war; and still it is not a co-ordinated policy, for cloth prices at controlled rates cannot be maintained merely by controlling the manufacturer and the trader. Government may succeed in preventing hoarding by the device they propose to adopt of stamping the date of manufacture upon the cloth; but they won't be able to control prices merely by stamping upon the cloth its legal retail price, as long as no steps are taken to regulate the

demand for cloth with respect to a reduced supply. R*educed supplies accompanied by increased demand is bound to result in a failure of price control unless it is accompanied by rationing and the necessary dimunition in demand.* Government has therefore still a long way to go before they can successfully tackle the problem of civil supplies and soaring prices.

To sum up the effect of the war on Indian industry, there has been a large increase in the money demand for the output of industry amounting to Rs. 409 crores by the end of September 1942, and excluding the value of the outturn of the ordnance factories. This has resulted in a big industrial boom, accompanied by rising prices, inflated profits and increasing dearness allowances. Production required for war purposes has been substantially increased, but not total industrial production. Combined with the fall in imports and the rise in exports of manufactured goods, this has resulted in an acute shortage of industrial goods available for civilian consumption. Government has failed to tackle this problem on the production side, though that could have been done by facilitating the establishment in the country of the heavy engineering and the heavy chemical industries or at

least by facilitating the import of machinery for industrial expansion in the field of civil supplies. They have also failed to harness the small scale and cottage industries of the country for increasing the output of civilian supplies. Finally they have also failed to take steps to prevent the scarcity of industrial goods from affecting the price-level, as they did not introduce price control over industrial goods except till recently with respect to cloth, nor have they introduced rationing. The net result of all this has been that on the one hand, the industrial opportunities offered by the war have not been availed of to fill up the gaps in the country's industrial structure; and on the other, civilian supplies have been greatly reduced and then left to the free operation of market forces with resultant inflationary consequences. It is a matter for some satisfaction that at last, even though it is only towards the close of the fourth year of war, Government has realised the importance of civil supplies and industries, and set up a separate department to deal with this question. It must be pointed out however that the problems created by the impact of war on industry cannot be isolated from the other results of war economy; and cannot be successfully handled without more control over additions to purchasing power in the country. In short, like

the food problem, the industrial problem is also seen to be only a part of the general problem of scarcity and inflation made even more difficult by the fact that it was being handled by Government against a background of political dissassociation between itself and the people.

CHAPTER VII.

THE WAR AND INDIAN CURRENCY.

The position of Indian currency on the eve of the war was determined by the provisions of of the Indian Currency Act of 1923, the subsequent order of 1931 delinking the rupee from gold and linking it to sterling, and the Reserve Bank of India Act of 1935. The Reserve Bank of India is in sole charge of the issue of paper currency and is also under a moral obligation to give rupees in exchange for its notes; It is required by law to sell and buy sterling at the rate of lsh. 6d. a rupee; and its reserve position was statutorily determined to the effect that it must have not less than 40% cover in the form of gold and sterling, of which gold was to be of a value not less than Rs. 40. crores. The rest of the reserve could be in the form of rupee securities, rupee coins and trade bills, the former not to exceed the sum of Rs. 50 crores. It was also laid down that the reserve of rupees should be kept at Rs. 50 crores, any reductions in the same being replenished by the Government of India. As regards credit, the scheduled banks were required to maintain with the Reserve Bank a minimum reserve of 5% of their demand liabili-

ties and 2% of their time liabilities; and they were given the privilege of re-discounting facilities with the Reserve Bank. The statistical position regarding currency in India on the eve of the war is given below:

(Figures in lakhs of Rs.)

Liabilities:		
	Total note issue ..	216,78
	Notes held in the Banking Department ..	37,89
	Notes in circulation ..	178,89
Assets:		
	Gold coin & bullion ..	44,42
	Sterling securities ..	59,50
	Rupee coin ..	75,47
	Rupee securities ..	37,39
	Total Assets ..	216,78

The percentage of gold and sterling to total note issue was 47.9% or well above the statutory minimum. It is worth noting that trade bills did not form part of the assets, thus indicating the failure of the Reserve Bank to develop a bill market in India, and also the absence of dependence on the Reserve Bank by the scheduled banks for their funds.

The position regarding bank deposits on the eve of the war *i.e.* on 25th August 1939 is given below: [1]

1. Deposit figures include Burma, Rs. 6,19 lakhs demand deposits and 4,57 lakhs time deposits.

(In lakhs of Rs.)

Demand deposits	..	142,58
Time deposits	..	106,87
Total liabilities	..	249,45
Cash balances with the Reserve Bank	..	26,61
Advances and Bills discounted in India & Burma	..	105,27

The average percentage of cash balances with the Reserve Bank for the year 1939-40 stood at 10.0 or well above the statutory minimum; advances and bills discounted in India accounted for 43.82% of the bank's total liabilities. The Reserve Bank rate stood at 3%.

With the outbreak of war, governmental control of private economic activity began; and the powers of Government under the Defence of India Ordinance to administer the regulations controlling dealings in coins, bullion, securities and foreign exchange was delegated to the Reserve Bank. All dealings in foreign exchange were required to be transacted through authorised dealers; while the purchase and sale of non-Empire currencies were largely restricted to genuine trade purposes. The policy of Exchange control was to see that all foreign exchange transactions in India were done on the basis of the rates quoted by the London Exchange

Control combined with the current rupee rate for sterling. But the real object of exchange control was something different; and it is admitted in the Reserve Bank's Report on Currency & Finance for 1940-41 that the exchange control regulations were mainly directed to conserving foreign exchange by limiting remittances except for essential purposes. From the point of view of India herself, such conservation of foreign exchange was not necessary because her balance of payments was favourable; in fact, in her case conservation of foreign exchange was to result in the problem of sterling balances and attendant inflationary consequences on the currency. But the Reserve Bank of India, instead of taking an independent line, merely followed the path chalked out by the Bank of England. It was certainly in Britain's interest to increase private exports, control private imports, and obtain as much foreign exchange as possible to facilitate her obtaining war material and equipment from foreign sources; but the position with regard to India was quite different; our imports had fallen, our exports were increasing and we were supplying so much material to foreign countries that an income and currency inflation was beginning to be experienced in the country. The correct exchange policy under the circums-

tances was to encourage private imports, discourage private exports and bring about a liquidation of our foreign exchange balances. But the Reserve Bank and the Government of India followed exactly the opposite policy as far as our private foreign trade and the exchange facilities necessary thereto were concerned. We have seen in our Chapter on Trade that this policy aggravated the problem of shortage in the country, contributed to the psychology of hoarding and acted as a powerful aid towards a rise in Indian prices. The explanation for this policy lies in the subordination of our exchange policy to that of the Bank of England. The Bank of England was interested in maximising its supply of non-sterling currencies, particularly of dollars, and preventing any drain on it except for purposes approved by it and by the British Government. It is this object which led to the acquisition of the dollar balances and securities of Indian residents by the Government of India in December 1940 and March 1941 acting in exercise of the power given by the Defence of India Rules 92 and 94. It is this object again which led to the control of exports being mainly directed to seeing that the Indian exporter was receiving "hard currency" for his shipments which in turn he had to surrender to the Bank

of England in exchange for sterling. It is this object again which led to the strict control which was exercised on imports from non-sterling countries. The objective of exchange control by the Reserve Bank was thus the conservation and increase of Britain's foreign exchange resources in dollars.[1] While this policy was in the interest of Britain, it was not the correct policy for India to follow, in view of the fact that it led to a greater accumulation of sterling balances for India than would otherwise have taken place; and, from the currency point

1. cf. "As the war developed and the strain on the U.S. dollar resources of the *Empire* (italics mine) became heavier, further measures were taken to conserve foreign exchange ..... The Reserve Bank issued corresponding instructions to its authorised dealers in foreign exchange that no sales in foreign exchange against imports that were subject to license were to be allowed unless the importer had first received an import license from Government"—Report of the Reserve Bank on Currency & Finance for 1941-42, p. 20. As regards exports, the same report mentions that "shipments of jute and rubber to any of the "hard currency" countries were thereafter only allowed provided the exporter financed the shipment by a method which would ensure that not only the 'hard currency' proceeds of the goods were received but that there could be no question of the exporters retaining the sale proceeds of their goods outside the Empire"—p. 17.

of view, it was not in the interest of India to go on accumulating sterling, for such accumulation meant the sale of sterling to the Reserve Bank, the consequent issue of additional rupee currency in India, and its inevitable consequence, viz., a rise of the general level of prices in India.

While the Reserve Bank of India cannot therefore be absolved from its responsibility for following an exchange control policy that led to the accmulation of sterling, it must be added in fairness that perhaps they could not help it owing to the pressure exercised on them by the Government of India acting under instructions from His Majesty's Government. It must also be added that, though they could not deal with the problem of accumulating sterling balances by encouraging imports and discouraging exports, both Government and the Reserve Bank tried to tackle the problem by repatriating India's sterling debt. Repatriation of India's sterling debt means the replacement of India's sterling debt by an equivalent addition to our rupee debt. The transaction is financed by the sterling balances of the Reserve Bank ; and it is complete only when the rupee counterparts are actually taken over by the Indian public. To the extent that the repatriation means simply replacement of sterling securities with the Reserve Bank by

equivalent rupee securities, it is not complete. The transaction is complete only when the rupee securities are purchased by the Indian public, and the rupee currency thus obtained is cancelled by the Reserve Bank. As we shall see later, this last thing did not happen; and to that extent re-patriation of sterling debt did not have the anti-inflationary effect which was its primary objective.

It has been pointed out repeatedly that we were accumulating sterling balances during the war; the reason why we did so was two-fold. One was the favourable balance of trade in private merchandise in India's favour which was not sought to be checked either by the Government of India or the Reserve Bank. The other was the vast supplies of stores and services which India was supplying to His Majesty's Government. The Government of India were acting as the agents of His Majesty's Government and obtaining payments in sterling; this sterling was sold by them to the Reserve Bank of India who issued rupee notes in exchange, and the rupee finance thus obtained was used by the Government of India to make payments to the Indian suppliers of goods and services. Much play has recently been made in the press about this fact and it has been suggested that the villain of the piece was the Government

of India, in so far as they undertook the responsibility of acting as the agent of His Majesty's Government for the purchase of supplies. I do not deny that many advantages both in respect of prices, and quality and quantity of supplies accrued to the British Government by their getting the Indian Government to act as their agent. But as far as the accumulation of sterling with its corresponding additions to the volume of Indian currency is concerned, I do not think the result would have been different even if a private-agency, say the U.K.C.C. or an Exchange Bank had been deputed to act as agent. The provisions of the Reserve Bank of India Act require the Bank to purchase in unlimited quantities sterling at the rate of 1sh. 6d. and pay for it in terms of rupees; and as long as these provisions of the Act remain in force, it does not matter who tendered the sterling—the addition to Indian currency was bound to take place. The villain of the piece, as far as the issue of more Indian currency is concerned, is the fact of the linking of the rupee to sterling. If there had been no such link, the responsibility for finding rupee finance would have fallen directly on the shoulders of the British Government; and sale of sterling securities etc. would have been undertaken by them, as it happened in the case of dollar securities.

But because the rupee was linked to sterling, the problem became easier for the British Government; they simply paid in sterling; and the consequences were left to be borne by the Reserve Bank and the Indian public. That the consequences have been rather terrible is already evident and can be easily seen by an analysis of the following facts taken from the Explanatory Memorandum on the Indian budget for 1943 :[1]

(In lakhs of Rs.)

1.	Sterling assets held by the Reserve Bank August 1939 ..	64,00
2.	Sterling purchased by Reserve Bank	
	Sept. 1939 — Jan. 1940 ..	63,00
	Feb. 1940 — Jan. 1941 ..	86,00
	Feb. 1941 — Jan. 1942 ..	90,00
	Feb. 1942 — Jan. 1943 ..	105,00
3.	Sterling payments by His Majesty's Government ..	505,00
4.	Sterling amounts involved in repatriation.	359,00
5.	Other sterling commitments ..	113,00
6.	Sterling holdings of Reserve Bank at the end of January 1943 ..	441,00

This large increase in sterling balances was necessarily followed by a vast increase in the volume of Indian currency; and as this additional currency, by the very nature of its creation, found its way into the hands of the public and

1. p. 46.

got added to the effective volume of purchasing power in the country, it had the effect of pushing up the level of prices in the country. I have already pointed out that repatriation of our sterling debt could not arrest this process in so far as it was not accompanied by a corresponding purchase of rupee loans by the Indian public. And that a part of the rupee counterparts of the repatriated sterling debt was not purchased by the Indian public and still remains in the form of *ad hoc* securities with the Reserve Bank and therefore the basis of an equivalent amount of rupee currency has been admitted by the Finance Member himself in his last Budget Speech. [1] The resultant increase in the volume of

1. "The broad position may be said to be that of some Rs. 400 crores raised so far for financing the repatriation and funding operations, only Rs. 160 crores may be regarded as being still in the form of Central Bank finance, since that is the amount by which the rupee securities held by the Reserve Bank as cover against its note issue exceed the corresponding figure at the outbreak of the war".—p. 20, Budget Speech.

Indian currency is given below :[1]

(In lakhs of Rs.)

	Progresssive increase or decrease in Note circulation during the year.	Progressive increase or decrease of rupee coin in circulation during the year.	Combined progressive increase or decrease of Notes & Coins in circulation.
1939-40	+ 49,45	+ 10,08	+ 59,53
1940-41	+ 19,11	+ 33,23	+ 52,34
1941-42	+ 152,40	+ 7,18	+ 159,58
1942-43	+ 262,33	+ 46,13	+ 308,46
Total	+ 483,29	+ 96,62	+ 579,91

1. Reserve Bank of India, Monthly Statistical Summary. From July 1940, Rupee coin includes one rupee notes. The increasing volume of currency and its immediate transfer to the public led to a big demand for rupee coins; part of the demand was also for hoarding purposes. To meet the situation, Government first reduced the silver content of the rupee from 10/11 to $\frac{1}{2}$, (Indian Coinage Amendment Act of 11th March 1940), imposed restrictions on the private holding of rupee coins and finally introduced the one rupee note (Ordinance of 24th July 1940). That the demand was not largely for hoarding but was for use as currency is seen by the large absorption of one rupee coins (which means really notes) during the year 1942-43.

There has been therefore an increase in the currency in circulation by Rs. 579·9 crores. In calculating the percentage of increase it is not sufficient to take into account only the volume of note issue; we must also take into account the volume of rupee circulation. It is true that no correct figures are available for tke latter and one has to go on the basis of estimates. Prof. P. C. Mahalnobis has gone into this question very thoroughly and has concluded that the available data are inadequate and that further investigation is required before a reasonably reliable method can be devised; he has, however, put forward a number of alternative estimates for the rupee circulation in 1939, varying from Rs. 104 crores to Rs. 165 crores.[2] Taking a figure of Rs. 150 crores as a rough approximation of the rupee circulation in 1939, we may tentatively place the combined rupee and note circulation in August 1939 at Rs. 329 crores. The increase in circulation is Rs. 580 crores or more than 176%, the increase in note circulation alone being as much as 270%.

That such a large increase in circulation, particularly when it takes the form of an increase in the effective purchasing power in the country,

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2. For more details see pp. 49-54, Report of the Reserve Bank on Currency & Finance for 1940-41.

is bound to have a stimulating effect on the price level goes without saying; that this has been the case is evident from the following statement of the course of wholesale prices in this country since the outbreak of war:

INDEX No. OF WHOLESALE PRICES.

	Calcutta (Base-July 1914 = 100	Bombay. Base-July 1914. = 100
August 1939	100	103
1939-40	115	115
1940-41	119	117
1941-42	144	158
April 1942	157	196
May ,,	169	203
June ,,	182	222
July ,,	182	225
Aug. ,,	192	228
Sept. ,,	198	229
Oct. ,,	209	233
Nov. ,,	227	249
Dec. ,,	238	266
January 1943	250	255
February 1943	253	255
March 1943	272	256

Whether this rise in prices can be regarded as inflationary or not is a question which has evoked a storm of controversy in the country; and it is desirable to devote a separate section to the discussion of this question. It would also be more appropriate to enter on this dis-

cussion after we deal with the question of how the present war is being financed, with which it is so intimately related.

We may however complete the statistical picture by reference to the volume of bank deposits. The relevant statistics are given below:

(Figures in lakhs of rupees-excluding Burma)

	Total Bank Deposits	Total demand deposits.	Total cheques cleared.	Proportion of cheques cleared to demand deposits.
1939-40	234,49	132,57	2307,77	17.4
1940-41	256,95	155,75	2018,54	13.0
1941-42	306,00	202,00	2568,66	12.7
1942-43	411,46	307,07	2773,03	9.0

A study of the table reveals several significant features. While demand deposits have risen considerably, the rise is not of the same order of magnitude as in the case of cash currency. Secondly even this increase seems to have been largely off-set by a decline in the velocity of circulation of bank money. Further evidence of the contention that much of this increase in bank deposits has not functioned actively but has merely remained as idle money is forthcoming from the fact that the percentage of advances

and discounts to demand and time liabilities has been steadily declining since the outbreak of war. * The significance of these facts in connection with the question of inflation will be discussed in Chapter IX, but it is relevent to note here that there is no absolute decline in the volume of cheque clearings, and to that extent there has been no off-set in the circulation of bank money to the expansion in the volume of rupees and notes in circulation.

* The relevant percentages are given below :—

1939-40	53.31
1940-41	46.93
1941-42	39.50
1942-43	23.85

CHAPTER VIII.

FINANCING OF INDIA'S WAR EFFORT.

As we have already pointed out in the Chapter II, India's war effort does not mean only the training and equipment of her own armed forces meant for service in India but also includes the training and equipment of armed forces meant for overseas service and the supply of goods and services for the military and other requirements of His Majesty's Government. It is true that the Indian tax payer bears only the cost of the first item; the second is borne by His Majesty's Government; but as payments have to be made in rupees, and these rupees are not obtained by the sale of an equivalent value of British goods in India, the rupee financing of this part of the war effort has also been left to the Government of India, and therefore constitutes a very important subject for discussion in this chapter. In fact, as we shall see later, it is this part of our war finance that has presented the most difficulties and caused the largest trouble to our economy.

To begin with, the defence expenditure debitable to Indian revenues since the outbreak of war including the budget estimates for 1943-44 amounts to Rs. 665.6 crores. Of this

amount Rs. 438.4 crores is ascribed to the war emergency. Details are given in the table found on the next page.

The figures for 1942-43 exclude an expenditure of Rs. 49, 14 lakhs, described as defence capital expenditure, the corresponding figure for 1943-44 being Rs. 16,85 lakhs. Including both these items, the corrected net expenditure on defence would come to Rs. 238,89 lakhs for 1942-43 and Rs. 199,66 lakhs for 1943-44. It will be seen that the tempo of war expenditure increased substantially in 1941-42 and reached its height in 1942-43 when our net defence expenditure was more than 4½ times the expenditure in 1939-40. The current budget year shows a fall particularly because of a smaller measure of defence constructional activity; but it is still very much above the 1939-40 figures, the increase being as much as 300%. The magnitude of our defence expenditure can be seen even more clearly when we realise that the amount spent during the five years 1939-40 to 1943-44 (budget estimates for the current year being taken for this purpose) is as much as the expenditure incurred by this country during the 13 preceding years. Looked at from another angle, defence expenditure incurred during this war—and it is not yet over—is already 214% more than the entire

(FIGURES IN LAKHS OF Rs.)

	1939-40 Accounts.	1940-41 Accounts.	1941-42 Accounts.	1942-43 R. E.	1943-44 B. E.
Defence Services-Effective.					
Normal budget ..	36,77	36,77	36,77	36,77	36,77
Lump provision for increase in prices ..	1,19	2,57	4,39	8,61	10,62
War Emergency ..	3,61	26,63	55,43	144,07	142,61
Defence Services-Non-effective ..	8,70	8,84	8,80	8,81	8,84
Total ..	50,27	74,81	105,38	198,25	198,83
Defence Services Receipts ..	73	1,19	1,45	8,50	16,02
Net Expenditure on Defence ..	49,54	73,61	103,93	189,75	182,81

defence expenditure incurred during the last war of 1914-18.[1] Absolute totals of war expenditure in other countries are really no guide to judge the comparative weight of India's defence expenditure; but even if we take the defence budget of Great Britain, the percentage rise in 1942-43 over the 1939-40 figures is not very much greater than in the case of India. I have emphasised these figures, as there is a tendency in some quarters in England to minimise the magnitude of the burden of India's defence expenditure. In spite of the terrible handicaps of a low national

1. Details are given below and refer to net military expenditure incurred by the Indian Government and debited to Indian revenues :

(figures in lakhs of Rs.)

1914-15	..	30,51
1915-16	..	33,39
1916-17	..	37,98
1917-18	..	43,56
1918-19	..	66,72
Total	..	212,16

It is interesting to notice that in one year alone of this war, viz., 1942-43, defence expenditure has come to Rs. 247,39 lakhs or 17% more than the defence expenditure incurred during the entire period of the last war, including the first six months after the declaration of armistice.

income and a limited taxable capacity, this country has suffered an increase in her military expenditure over pre-war totals, which is at least as high as in the case of any of the United Nations, and in fact higher than in that of many of them.

It is also a matter worth noting that a substantial portion of this increase in our defence expenditure has been met by additional taxation. The following statement summarises briefly the additional tax measures imposed by Government since the outbreak of war:

ADDITIONAL TAX MEASURES.

Budget Year		
1940-41	..	New duty of 50% on excess profits.
		Increase in the excise duty on sugar from Rs. 2 to Rs. 3 per cwt.
		Increase in the duty on motor spirits from 10 annas to 12 annas per gallon.
		Increase in the railway rates on goods traffic by 12½% excluding food grains, fodder, manures, and railway and military traffic, and partially coal.

		Increase in passenger fares by one anna in the rupee.
1941-42	..	Increase in Excess Profits Duty from 50% to $66\frac{2}{3}$%
		Increase in Central Surcharge on the income tax and super tax from 25% to $33\frac{1}{3}$%
		Increase in the excise duty on matches by 100%.
		Increase in the import duty on artificial silk yarn and thread from 3 as. per lb. to 5 as. per lb.
		New excise duty of 10% *ad valorem* on pneumatic tyres and tubes.
1942-43	..	Revision of the surcharges on income tax and super tax from a flat rate basis to a graded basis, with generally higher rates on the larger incomes.
		Increase of corporation tax from 1 anna to $1\frac{1}{2}$ as. per rupee of corporate profits.
		Imposition of a surcharge of 20% on the entire field of customs import duties.

Increase in postal and telegraph rates, inland covers from $1\frac{1}{4}$ annas to $1\frac{1}{2}$ annas, minimum telegraph charges from 10 annas to 12 annas for ordinary and from 1-4-0 to 1-8-0 for Express telegrams.

Increase in telephone rentals, and increase in the surcharge on trunk calls from 10 to 20%.

1943-44. .. Increase in income tax rates, on incomes from Rs. 5000 to 10,000 from 9 pies to 10 pies in the rupee, on incomes from 10,000 to Rs. 15,000 from 14 to 16 pies in the rupee, on the balance above Rs. 15,000 from 15 pies to 20 pies in the rupee.

Increase in the super tax on the slabs of income between Rs. 25,000 and Rs. 3 lakhs by a uniform rate of half an anna in the rupee.

New excise duty on tobacco, at such rates as will yield Rs. 10 crores.

New excise duty on vegetable products known as *Vanaspati* at Rs. 7 per cwt.

Certain increases in postal and telephone rates consisting of an increase in the inland letter rate for each tola after the first from $\frac{1}{2}$ anna to 1 anna, an increase in the inland parcel rate for the first 40 tolas from 4 annas to 6 annas, and an increase in the existing surcharge on telephone rentals from 1/6th to $\frac{1}{3}$.

It will be seen therefore that the additional taxation borne by India as a result of the war has been heavy and substantial, and it has fallen on all classes The poor have suffered in the shape of additions in railway rates, additions in postal rates, additions in the existing import and excise duties, and imposition of new excise duties. The well-to-do have also suffered by a 66% increase in the rates of income tax. Owners of war profits have also been made to pay though perhaps not as much as they should have, as the excess profits duty is only $66\frac{2}{3}\%$. The total amount thus raised by way of additional taxa-

tion since the outbreak of war comes to Rs. 214,33 crores, including the net revenue from railways and posts and telegraphs and the amount proposed to be raised during the current budget year. Details are given on the next page.

Even excluding the net revenue from Railways—a good part of which is the result of enhanced rates—it will be seen that the tax revenue of the Government of India has been more than doubled during the last four years. A 100% increase in taxation is certainly not a small burden and India has had to put up with this increase on account of the war. When it is recalled that this excludes the revenue from increased railway, postal, telegraph and telephone charges and that the burden of taxation in India on the eve of the war was already very high, credit must be given to the tax payers of India for the magnitude of their sacrifice and the fortitude with which they have borne the increased burdens.

It may be argued, however, that this increase in taxation is only in money terms and that it does not represent an equivalent increase in the real burden of taxation, as the price level in the country has gone up a

(FIGURES IN LAKHS OF Rs.)

	1939-40	1940-41	1941-42	1942-43 R. E.	1943-44 B. E.
Customs ..	45,88	37,30	37,89	31,00	30,00
Excise ..	6,52	9,49	13,15	12,68	25,42
Income tax & allied taxes ..	16,58	21,77	36,67	67,10	89,90
Salt ..	10,86	7,67	9,20	10,50	9,50
Other tax revenue ..	99	1,14	1,20	1,20	1,19
Net revenue from Railways ..	4,33	12,17	20,17	20,13	27,10
Net revenue from Post & Telegraphs ..	89	1,25	3,40	5,55	8,36
Currency & Mint ..	88	96	2,17	3,35	3,57
Total ..	86,93	91,75	123,85	151,51	195,04
Increase over 1939-40 ..	—	4,82	36,92	64,48	108,11

great deal and with it presumably the money level of the national income. But the cost of living has also gone up in the country. The real value of national income would depend upon not only the increase in money incomes, but also the extent to which that has been neutralised by an increase in the cost of living. If we take the index of increase in wholesale prices as indicative of the increase in money incomes it would be necessary to correct it by reference to the index of increase in cost of living in order to arrive at the increase in real income. Taking the Bombay wholesale price and cost of living indices for this purpose, we find that while wholesale prices have gone up by 156%, cost of living has also gone up by 108%. The increase in real income represented by the increase in money income is therefore only 23%. Moreover, it must not be forgotten that the rise in wholesale prices has not resulted in an equivalent increase in the incomes of large classes in the country—notably those of the salariat, the rentiers and the landless proletariat—, while the rise in the cost of living has affected everyone in the country. Under the circumstances, we must conclude that the increase in the money burden of taxation

does represent a large rise also in the real burden of taxation. Even allowing for a rise in the real national income on the assumption that it is indicated by the rise in wholesale prices corrected by the rise in the cost of living, the increase in the real burden of taxation comes to 82%[1] Moreover, it must not be forgotten that in so far as the rise in the cost of living is a direct result of Government's policy with regard to the financing of war expenditure, the burden on the public is far greater than is measured merely in terms of taxation. We shall revert to this point later.

We may also deal with the argument that the proportion of national income taken by way of taxation in India is much less than in other Allied Nations and that therefore the comparative tax burden in India is less. In instituting such comparisons, account must be taken not only of the proportion of tax to

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1. If national income in 1939 was X, and if the rise in wholesale prices represents an increase in incomes, the money national income in March 1943 would be X + 1.56 X or 2.56 X. But the rise in the cost of living is 108%. The real national income would therefore be 2.56X ÷ 2.08 or 1.23X. The increase in money taxation including net revenue from commercial departments is 124%. The net increase in the real burden of taxation is therefore 82%.

national income but also of the total volume of national income. It is well known that, in the case of private individuals, the burden of sacrifice involved per unit rate of taxation gets progressively less with increasing income. Subject to certain limitations regarding distribution, the same applies also to the burden of taxation on the total national income. In the case of India, the national income per capita is so low that a considerable section of the population has, from a theoretical point of view, no taxable capacity at all, as their income is not sufficient to provide them even with the bare necessities of life. It has been acknowledged on all hands that the burden of taxation was already heavy in India before the outbreak of war;[2] and the doubling of taxation within 4 years really representsa tremendous increase in this burden.

Even this large additional taxation was not sufficient to meet the increased expenditure arising from the war. In fact, every belligerent nation has had to resort to borrowing and the Government of India did the same. Defence Loans were floated and the Viceroy's War Purposes Fund instituted for receipt of gifts. Special interest-free Defence Bonds were also

2. This fact finds expression in the Otto Nimeyer Report, as well as in the speeches of the Finance Member.

issued for subscription. A special attempt to get at the poorer class was also made by the issue of ten-years Defence Savings Certificates, and the opening of special Defence Savings Accounts in the post offices. An attempt was also made to raise loans from the income class between Rs. 1,000 and 2,000 and from the payers of excess profits duty by offering concessions on extra payments. The net result of these attempts are summed up in the table found on the next page.

Taking the entire period including the budget year 1943-44 the total new debt created (actual and proposed) comes to Rs. 623,15 lakhs being made up as under :—

Loans proper	..	Rs. 409,37
Treasury Bills	..	,, 170,68
Unfunded Debt	..	,, −34,42
Other debts	..	,, 77,52

It will be seen that the unfunded debts actually recorded a fall; the fall as far as Post Office Savings Deposits and Postal Cash Certificates were concerned was much greater, being as much as Rs. 53,27 lakhs, but this was offset to some extent by an increase in Service Funds. Against this total new debt of Rs. 623,15 lakhs, the compulsory obligations of the Government of

(FIGURES IN LAKHS OF Rs.)

	1939-40 R. E.	1940-41 R. E.	1941-42 R. E.	1942-43 R. E.	1943-44 B. E.
New Loans ..	—	53,40	73,00	60,00	100,00
Treasury Bills (net) ..	−6,00	8,00	16,00	137,00	−57,00
Post Office Cash Certificates (net).	− 50	−10,00	− 7,00	− 5,00	− 3,00
Defence Savings Certificates ..	—	2,34	2,30	1,00	2,00
Post Office Savings Bank Deposits (net) ..	5,02	−19,00	− 7,17	− 2,10	2,70
Defence Savings Deposits ..	—	—	a1	25	50
Ways & Means Advances ..	—	20,00	−16,00	—	—
Other unfunded debt ..	3,73	2,91	3,28	2,31	2,81
Total ..	2,25	57,65	64,30	193,46	48,01

India amounted to Rs. 301,38 lakhs, of which Rs. 160, 54 lakhs consists of the uncovered deficits during the years 1940-41 to 1943-44 and Rs. 140,84 lakhs consists of special reserves and the capital outlay incurred during the period.[1] There still remained a substantial sum of Rs. 321,77 lakhs, which was utilised for sterling debt repatriation and discharge of the rupee loans falling due within the period. It is sufficient to note here, however, that so far as the increased expenditure of the Government of India due to the war was concerned, the balance not covered by taxation was easily and amply covered by the new debt; even if we exclude from it the floating debt in the form of Treasury Bills. In other words, financing of the war expenditure of India proper did not present any difficulty; and was in fact accomplished more satisfactorily than in many other countries, the proportion financed by fresh taxation, including the net revenue from commercial departments, being as much as 49%.

But we have seen that Government raised more loans than were necessary to finance the

1. Details are given on the next page and are compiled from the explanatory memoranda attached to the Budget statements for 1939-40 to 1943-44.

balance of their war expenditure. This was due

(FIGURES IN LAKHS OF Rs.)

	1939-40 R. E.	1940-41 R. E.	1941-42 R. E.	1942-43 R. E.	1943-44 B. E.
Capital outlay on Railways ..	4,24	2,29	3,88	23,94	13,00
,, ,, Post & Telegraphs ..	8	4,81	36	36	3,20
,, War Schemes ..	—	—	—	97	10,46
,, Other civil heads ..	19	15	34	66	20
,, Defence ..	—	—	—	49,14	16,85
Commutation of pensions ..	— 9	— 22	— 30	— 26	— 29
Civil Aviation ..	14	— 5	6	17	12
Economic Development & improvement of rural areas ..	26	21	23	20	11
Broadcasting ..	7	3	4	2	2
Developments in tribal areas in N.W.F.P. ..	2	— 12	— 11	— 25	— 23
Telephone Development Fund ..	—	—	20	44	—
Loans to Public (net) ..	— 59	— 50	— 95	1,29	— 78
Advances to Provincial Governments ..	— 1,35		77	4,60	3,10
Payments to Reserve Bank for surplus siver ..	5,00	— 200	—	—	—
Total ..	7,97	4,60	4,52	81,28	45,76

This table excludes the capital outlays involved in the discharge of permanent debt, as they relate mainly to the repatriation of sterling debt which is linked up with the finding of rupee finance for the British Government's requirements in India.

to the fact already mentioned both in Chapter II and in this Chapter, that the Government of India was also entrusted by the British Government with the responsibility for finding rupee finance against sterling tendered by them as payment for the purchase of supplies in India of both goods and services. The expenditure incurred on behalf of the British Government in India was of a twofold character. One was strictly military and consisted of the payment made by the British Government in accordance with the formula for the allocation of war expenditure incurred on Indian forces. The other consisted of payment for supplies of goods and services puərchasd by the British Army and their Allies for use both in India and abroad. An illustration of the former would be the cost of Indian troops serving overseas ; an illustration of the latter would be the purchase of wheat or cloth for use in the Near East and in the Middle East. It is difficult to get an accurate idea of the magnitude of these amounts, but taken together they form an undoubtedly substantial total.

The British part of the military expenditure was determined under the Financial Settlement between His Majesty's Government and the Government of India negotiated in November

1939.[1] Under it, India is to pay :

(a) her pre-war normal budget for effective charges of Rs. 36.77 crores.

(b) a sum in adjustment of the normal budget for rises in prices.

(c) the cost of "Indian War Measures", that is, such measures as can be regarded as purely Indian liabilities by reason of their having been undertaken by India in her own interests

(d) a contribution towards the additional costs of her external defence. This has been fixed at a lump sum of Rs. 1 crore per year.

His Majesty's Government is to pay for the remainder of all general defence and supply expenditure incurred by India. Expenditure on supply in its widest sense-the production of guns, ammunition, armoured cars, clothing and warlike stores of every description-was so closely related to direct defence expenditure that it also was covered by the Financial Settlement. The arragement was, broadly speaking, the same; India pays for whatever she takes from Indian production for Indian war measures and for

1. Vide p. 7 of the Finance Member's Budget Speech for 1943-44

her share of joint war measures, including storage charges ; and His Majesty's Government pays for and owns all the remaining stores produced, together with practically all the capital assets created for the purpose of expanding production and storage.

We have already seen that the total expenditure of "Indian War Measures" determined under this Settlement came to Rs. 465,97 lakhs during the first four years of the war and is expected to reach Rs. 665,63 lakhs by the end of the current budget year. The war expenditure incurred by the Indian Government on behalf of the British Government was placed by the Finance Member at nearly Rs 200 crores for 1941-42 and at more than Rs. 400 crores for 1942-43[1]. No quantitative estimates are available either for 1940-41 or for 1943-44. These figures evidently include supplies as well, but it is difficult to separate the two from the data available to the public. Even as regards the total, no official figures are forthcoming. But an approximate idea can be had from a study of the sterling resources acquired by the Reserve Bank of India since August 1939. This figure amounts to Rs. 851 crores

1. pp. 7 and 10 Finance Member's Budget Speech 1942-43.

up to the end of December 1942. As the favourable balance of trade on private account amounted only to Rs. 242 crores during the period, the reminder viz, Rs. 609 crores can resonably be assumed to indicate the total rupee finance provided by the Government of India up to the end of December 1942 for His Majesty's Government against an equivalent value of sterling received in England.[1] It may be added that the sterling assets held by the Reserve Bank has increased by a further amount of Rs. 30 crores in February, 1943 and is expected to rise very much further before the end of the current budget year.

How did the Indian Government find this huge volume of rupee finance? It must be repeated that this was over and above the financial requirements necessitated by their own war measures amounting to Rs. 466 crores by the end sf March 1943 and expected to reach Rs. 666 crores by the end of March 1944 and which was found partly by taxation and partly by borrowing. The

1. Actually the total would be larger, for a part of the sterling acquired from the British Government was used directly to meet the Indian Government's sterling expenditure in England and was therefore not sold to the Reserve Bank. It is difficult to get accurate figures of the amount involved.

finance required for the British Government could be found only by borrowing. Loans equivalent to the rupee finance required by the British Government had to be obtained from the Indian public, and this could take the form either of rupee debt floated directly by the British Government or rupee debt floated by the Indian Government and having as its asset an equivalent value of sterling securities; so that it could not be treated as unproductive debt. To the extent that the Government of India had a sterling debt, the same object could also be accomplished by the repatriation of the sterling debt i. e., by raising a corresponding amount of rupee debt the proceeds of which could be utilised to cancel the sterling debt. But sterling debt repatriation could not also solve the problem in so far as the rupee finance required by the British Government exceeded the rupee equivalent of the Indian Government's sterling debt.

The Indian Government tried its best to raise the required rupee finance by additional borrowing from the Indian public. But they could not wait till the loan proceeds came in, while the rupee finance required was urgent and continuous. Government therefore resorted to the easy method of getting their sterling receipts converted into rupee finance through the agency

of the Reserve Bank. In other words, the sterling received from the British Government was sold to the Reserve Bank who paid for the same by issuing additional rupee currency. Thus, instead of the rupee finance being obtained by transfer of purchasing power from the Indian public, additions were made to their purchasing power in the course of finding rupee finance for the British Government's requirements. The natural result was a rise in Indian prices. The addition was small in the beginning, and then began rapidly to increase, reaching its climax in 1942-43 ; prices in India followed suit, rising gradually in the beginning, then steeply in 1942-43. The rise in prices necessitated an increase in the volume of rupee finance required ; this in turn raised the volume of sterling assets and therefore the volume of additional currency and purchasing power ; this was followed by a further rise in prices and so the inflationary spiral set in.

Government tried to arrest this tendency by instituting measures for the repatriation of our sterling debt. Purchases of sterling securities were made in the open market in 1939-40 ; in February 1940, Government announced a scheme for the repatriation of terminable Sterling Loans and giving details of the terms on which conversion could be effected. Early in 1941, the

license scheme was replaced by a more comprehensive scheme of repatriation; and with the assistance of the British Government, power was taken compulsorily to acquire India's sterling debt of the face value of £ 90 millions. In December 1941, this was followed up by another scheme applicable to the non-terminable portion of the sterling debt; this last transaction was financed by the issue of *ad hoc* treasury bills to the issue department of the Reserve Bank, as it was thought undesirable to issue rupee counterparts in the then depressed price level of Indian securities. The table on the next page gives details of the debt repatriated from 1939-40 under the various schemes, their purchase prices and the rupee counterparts created. [1]

The process of repatriation was continued in 1942-43, the bulk of the rupee finance being provided in the form of *ad hoc* treasury bills. Thus, by the end of 1942-43, some £300 millions of sterling debt has been repatriated, the balance still left being only £13 millions.[2] And in the words of the Finance Member, "thus India has completed the transition from a debtor to a creditor country and extinguished within the brief

1. p. 37 Reserve Bank Report on Currency & Finance for the year 1941-42.

2. p. 19 Finance Member's Budget Speech for 1943-44.

Year.	Manner of repatriation.	Face value £ millions.	Purchase Value £ Millions.	Purchase Value Rs. Crores.	Amount of rupee counter-part created Rs. crores.
1939-40	Open market purchases ..	17.09	16.54	22.05	22.79
1940-41	1. ,, ,, ,, ..	9.22	8.52	11.36	12.10
	2. License scheme of 22nd Feb. 1940 ..	2.02	2.02	2.69	2.69
	3. First compulsory scheme of 8th Feb. 1941 ..	60.05	64.70	86.27	80.07
1941-42	1. Open market purchases ..	12.11	12.36	16.48	16.14
	2. First compulsory scheme of 8th Feb. 1941 ..	13.08	14.14	18.85	17.44
	*3. Second compulsory scheme of 24th Dec. 1941 ..	73.85	65.78	87.71	—
		187.42	184.06	245.41	151.23

* As already stated in the text, this transaction was financed by the creation of *ad hoc* treasury bills in the Issue Department for Rs. 90 crores of which Rs. 75 crores remained outstanding at the end of March 1942.

space of about three years accumulations over decades of its public indebtedness to the United Kingdom."[1] We shall deal with the significance of this result on Indian economy in a later chapter. For the present, however, our main concern with the sterling debt repatriation is how far it has enabled our Government to find rupee finance for the British Government without increasing the sum total of purchasing power in the country. This would have been accomplished if rupee loans equivalent to the repatriated sterling debt had been subscribed to by the Indian public. We have seen, however, that this has not been so. In fact, a substantial portion of the finance has been provided by *ad hoc* treasury bills issued in favour of the Reserve Bank, and even of the rupee counterparts issued up to March 1942, less than half has been taken up by the public. It must be added that a part of the amount required was obtained from the balances of the Government of India and was utilised to cancel a part of the newly created rupee counterparts, thus reducing the net total of Indian public debt.[2] But it is difficult, as the Finance Member has pointed out in his latest Budget Speech, to state with precision to

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1. Ibid, p. 2.

2. cf. "Out of some Rs. 139 crores of rupee counterparts created since the repatriation was first undertaken, Rs. $47\frac{1}{2}$ crores had been cancelled, Rs. 51 crores were in the hands of the public, a little over Rs. 31 crores were held by the Reserve Bank and Rs. $9\frac{2}{3}$ crores were held on Government account"—p, 15, Finance Member's Budget Speech for 1942-43.

what extent the funding of floating debt raised for the purposes of rapatriation has been achieved, since borrowing of both temporary and permanent nature is resorted to for other purposes besides repatriation and Government's balances are also increased by the payment which the Reserve Bank makes from time to time for the "Rupee Coin" that it takes over. "The broad position may be said to be that of some Rs. 400 crores raised so far for financing the various repatriation and funding operations, only Rs. 160 crores may be regarded as being still in the form of Central Bank finance, since that is the amount by which the rupee securities held by the Reserve Bank as cover against its note issue exceed the corresponding figure at the outbreak of the war."[1] In other words, to the extent of Rs. 160 crores at any rate, the rupee finance has been provided by the creation of additional purchasing power brought about through the currency mechanism. It is this which has earned the title of "naked inflation" at the hands of Prof. C. N. Vakil.

But the rupee finance required by the British Government is greater, and substantially greater, than the rupee equivalent of India's sterling debt. We have seen that the Indian public has

1. Ibid p. 20.

not provided rupee finance even to the extent of the repatriated sterling debt and Government has had to provide the remainder from its own balances, and by additions to the volume of paper currency. It follows therefore that the excess of the rupee finance required for the British Government over the amount equal to our sterling debt would have had to be provided by the Indian Government by the use of the currency mechanism. And this is exactly what has happened. Sterling assets of the Reserve Bank have been rising week by week and the volume of paper currency in circulation has been following suit. We have seen in Chapter VII that from Rs. 179 crores in August 1939 the volume of paper currency in circulation had risen to Rs. 588 crores in January 1943, and today it stands at Rs. 663 crores.[1] The sterling assets of the Bank stand at Rs. 468 crores in the Issue Department and Rs. 81 crores in the Banking Department. The easy path of creation of paper currency has been followed for finding the bulk of the rupee finance required by the British Government; it is true that the additional currency is backed largely by sterling assets, and even the rupee *ad hocs* which form the balance of its cover are not *ad hocs* in the ordinary sense but have been created in place of cancelled sterling debt, and form there-

1. as on 9th April 1943.

fore potentially genuine rupee securities which are waiting for absorption by the public; but the fact remains that the result has been an enormous addition to the volume of currency in circulation in India with a consequent rise in the general level of prices and in the cost of living. The use of the currency mechanism for finding the bulk of the rupee finance required by the British Government has therefore meant a compulsory transfer of resources from the public to the British Government, a gigantic, compulsory and country-wide national loan to the British Government against the backing of sterling securities deposited with the Reserve Bank with the added disadvantage that its incidence is spread unevenly over the different classes of the population and no *quid pro quo* is provided to the individual members of the public from whom real purchasing power has been so arbitrarily acquired. In fact, from the strictly economic point of view, this use of the currency mechanism for the acquisition of rupee finance is nothing but a concealed form of taxation, which is generally known in economics as inflationary taxation. The only difference between this and the ordinary form of inflationary taxation is that from the

national point of view, the amount raised is backed by sterling assets; from the individual's point of view, it is just taxation and very bad taxation at that.

The position up to the end of March 1943 can be summed up in the following statement :

(Figures in crores of Rs.)

1.	Rupee loans raised in India excluding Treasury Bills since the outbreak of war ..	309
2.	Rupee loans required on account of budget deficits due to Indian War Expenditure and capital outlay ..	215
3.	Excess of item 1 over 2 ..	94
4.	Rupee loans required to finance the rupee requirements of the British Government ..	more than 650
5.	Rupees obtained by loans or from Government balances for providing rupee finance for the British Government as measured by the sterling debt repatriated through means other than Central Bank Finance ..	199
6.	Excess of item 4 over 5 ..	more than 450
*7.	Excess Paper currency in circulation in Feb. 1943 over that in August 1939.	484

* The excess in the volume of new paper currency resulting from the favourable balance of trade on private account and the use of the currency mechanism for finding rupee finance for His Majesty's Government would have been greater but for the fact that a part of this rupee finance was met from the Government of India's balances, while a part of the sterling acquired was used for meeting the Indian Government's sterling requirements.

As item 3 is much less than item 6, the balance has had to be made up by an increase in the volume of currency. From the point of view of the effect on prices, the existence of sterling assets behind the increased currency is a matter of irrelevance. It is, however relevant to point out that this method of finding rupee finance tends to push up prices not only against the public but also against Government and results in an automatic increase in the money expenditure required not only for British purposes but also for purely Indian purposes.

It is interesting to inquire how this could have been avoided. I believe that the real cause of the trouble has been the linking of the rupee to sterling and the unwillingness or inability of the public to subscribe to Rupee loans to a substantial extent beyond the requirements of Indian War Expenditure. If the rupee had not been linked to sterling, the British Government would have had to shoulder the responsibility of finding the rupee finance they required; and they would have done it in the normal way, viz., by selling British investments in India, both governmental and commercial, by raising rupee loans, by sending goods and gold to India, and by limiting their requirements of rupee finance to the total of the sums that could be raised by these three methods.

But because the rupee was linked to sterling, their problem became simple; they just paid in their own currency, viz , sterling and it was left to the Reserve Bank and the Government of India to deal with the problem of finding the rupees. The Government of India made some attempts to find the rupees from the public by issuing rupee loans with which they could reduce the country's indebtedness; but they found that the necessary response was not forthcoming from the Indian public in adequate measure. There is no doubt that part, at any rate, of this unwillingness of the Indian public was the result of political causes and represented public dissatisfaction with the absence of a national and popular government at the Centre. Here was at work one of the basic features of Indian economy referred to in Chapter II; and the obvious remedy was not applied by the Government of India. I can't help feeling that the Government at Whitehall would have realised the need for a national government in India and worked for it, if they had been directly responsible for finding rupee finance and if the rupee had not been linked to sterling. But since that was not the case they were perhaps not equally interested; and the odium of inflationary finance fell upon the Government of India

for finding the rupee requirements of the British Government. There are three alternatives open to the Indian Government for finding the required rupee finance without inflationary consequences ; and these will be discussed in greater detail in later chapters. It is sufficient here to enumerate these alternatives :

1. increasing taxation, introducing compulsory loans and fixing the cost of living. The first two will bring in rupees without increasing the total purchasing power ; the third will reduce the amount of rupees required.
2. repatriation of British commercial and industrial investments in the country.
3. limiting the rupee requirements of the British Government to the amounts that could be raised by these methods in addition to the normal excess of rupee loans over the sum required to meet India's uncovered deficit and capital expenditure.

Government has not done either the second or the third, while their efforts in regard to the first have not been adequate. The result is that that part of our war effort which relates to rupee requirements of the British Govern-

ment and for which responsibilty has been saddled on the Government of India is being financed mainly by increases in the volume of currency. In other words, while India's own war effort has been financed on sound lines, that of the British war effort in India is financed largely by inflationary methods ; but the consequences of the inflation are borne by the Indian people. It is obvious that one of the countributory causes, actually the major cause, of the rise in Indian prices since the outbreak of war has been this finding of rupee finance for the British Government. The result has been an immense increase in the real burden of the war effort in India, partly due to the rise in prices and cost of living bringing about an increase in the totals of India's own war expenditure, and partly due to the rise in the cost of living and consequent popular suffering occasioned by the rupee finance provided for the British Government without a corresponding *quid pro quo* to the individual taxpayer.

In the next chapter, we proceed to discuss in greater detail this question of rising prices in India and its connection with inflation and scarcity.

APPENDIX TO CHAPTER VIII.

In discussing the question of the financing of the war effort, account has been taken only of that part of it which has given immediate rise to monetary expenditure. But the actual cost of the war incurred by India exceeds the money totals mentioned in Chapter VIII. Thus e.g. supplies required by both the Indian and British Governments have been purchased at controlled prices which are considerably lower than the market prices which the civilian purchaser has had to pay. Then again, military traffic, including that debitable to the British Government, has been charged lower rates by Indian Railways in respect of both freight and personnel. There is also the heavy capital depreciation suffered by Indian roads, Railway equipment and industrial machinery the effect of which will be felt within a fairly short period. There is also the loss suffered by Indian industries because of the difficulties placed in the way of their expansion by the diversion of industrial resources—including raw materials, semi-finished goods and capital-equipment—to war purposes. Finally there is all the incalculable human suffering resulting from the inflationary method employed by Government

for securing rupee finance in contrast to the ease of British War Finance resulting from the absence of a 'transfer problem' regarding their payment for purchases from India. It is difficult to calculate the value of these costs in money terms, but the fact remains that the real cost of the war for India exceeds the money cost represented by the Indian Government's expenditure and the British Government's sterling payments to India, and that too by a substantial margin. The writer would not have emphasised this fact but for the unanimity with which important sections of the British Press seem to be bent on minimising the cost of the war expenditure incurred by India.

CHAPTER IX.

SCARCITY, INFLATION & RISING PRICES.

Whatever may be the difference of opinion about the causes of the rise of prices in India, there is no dispute about the fact of the rise in prices. What is perhaps not quite so vividly realised is that the rise in prices has not been continuous and uniform since the outbreak of war, but has really become a matter of concern only from April 1942. The position is clear from the following table of the annual average of the wholesale price index in India:

	Calcutta index : Base July 1914 = 100	Bombay index : Base July 1914 = 100	Economic Adviser's index Base Aug. 1939 = 100
August 1939	100	103	100
1939-40 (last 7 months)	123	126	126
1940-41	119	117	115
1941-42	144	158	137
1942-43	211	251	184

The continuous and accelerating character of the rise in the last 12 months is seen more clearly

from the following table of monthly index numbers of wholesale prices and explains the reason for the concentration of public attention on this question:

Month and Year.		Calcutta Index	Bombay Index	Economic Adviser's Index
March	1942	153	197	144
April	,,	157	196	146
May	,,	169	203	148
June	,,	182	222	155
July	,,	182	225	160
August	,,	192	228	160
September	,,	198	229	164
October	,,	209	233	171
November	,,	227	249	177
December	,,	238	266	185
January	1943	250	255	190
February	,,	253	255	198
March	,,	272	256	214

What is this rise of prices due to? Is it not necessary to arrest its further progress, and if so, how can this be achieved? All these questions have been agitating the minds of the Indian public during the last few months and there has been a host of literature on the subject in the form of articles, lectures, pamphlets, etc. The present writer has also contributed his quota to

the same;[1] but the credit for pointedly drawing the attention of the country as a whole to the urgency of this question goes to Prof. C.N. Vakil who put forward with admirable lucidity the inflationary explanation of the rise in prices and suggested measures for countering the inflation.[2] Prof. Vakil's case was that the war had seen an increase in the volume of currency that was much greater than the proportionate increase in production; that this increase in currency was brought about by the Indian Government undertaking to find rupee finance for His Majesty's Government and doing so by sale of sterling to the Reserve Bank of India and also by issue to the Reserve Bank of *ad hoc* securities—which last process he described as naked inflation—and that the resulting increase in the volume of currency in circulation was the cause of the rise in prices and could therefore be regarded as nothing else but a dangerous form of inflation. Prof. Vakil's

1 In the form of special articles contributed to the *Bombay Chronicle, Social Welfare and the Hindustan Times.*

2. "The Falling Rupee" by Prof. C.N. Vakil. The interest of the public as also the lucidity of the writer's exposition is seen from the fact that the book ran into two editions within a month of its publication.

thesis was not accepted by certain leading businessmen of the country who were impressed by the fact that in their daily experience, they came across shortages in all important commodities and who felt therefore that shortage, and not inflation was the prime cause of the rise in prices; they also attempted to answer the argument regarding increase in the volume of paper currency by drawing attention to the fall in the velocity of circulation of bank deposits and concluded therefore that the increase in the volume of currency was rendered idle and had no effect on prices. The leading exponent of this view was Mr. G.D. Birla who argued his case with great clarity in a series of special articles contributed to the Hindustan Times of Delhi and later reprinted as a pamphlet.[1] Another point of view—and this had large affiliations with the official view on the subject—was put forward by Dr. L Nemenyi, who argued that the increase in the volume of currency was "quite normal, almost sub-normal for times of war", and that the explanation was mainly psychological, and that the rise in prices was chiefly due to "the accumulated effects of speculation, hoarding, general ignorance about monetary matters and the outcome of statements,

1. " Scarcity or Inflation" by G.D. Birla.

speeches, pamphlets, etc."[1] The Finance Member's own exposition is rather half-hearted; it contains arguments against explaining the rise in prices in terms of inflation but suggests that it is a "temporary situation in which an increase in the volume of purchasing power impinges for a time on a stationary or diminishing volume of consumable goods."[2] Finally, Prof. Vakil's view has recently found a large measure of support among the world of Indian economists, twenty of whom have issued a public statement saying that "The rapid rise in the general price level during the last two years and the enormous expansion of currency in India are, we feel, causally related." After stating that this increase in the volume of currency is the result of new notes against sterling acquired in return for British and Allied purchases in India, the economists proceed to state: "The net inflationary gap in India's finances counting in the finance made on behalf of His Majesty's Government is thus being wholly filled by the creation of more currency. The inflation in India is therefore, a deficit-induced, fiat-money inflation. It is the most

1. "War & Prices" by Dr. L. Nemenyi "The Statesman", Feb. 24, 1943.

2. pp. 22-23 Budget Speech for 1943-44.

disastrous type of inflation. The repatriation of India's sterling obligations does not act as an anti-inflationary factor except to the extent to which the rupee counterparts are taken up by the public, but this has so far been only small in proportion." They then go on to suggest measures for dealing with the situation which we shall discuss in a later section.

What light does our analysis of the effects of war on Indian economy throw on this question? I think it must have been already clear to the careful reader that the phenomenon of rising prices in India cannot be accounted for exclusively in terms of any one of the explanations offered above.

To begin with, there is no doubt that, as a result of the war, there is a real shortage of a number of commodities—especially manufactured commodities—in the country today. This has been amply illustrated in our Chapters dealing with the effect of war on Indian Trade and Transport and to some extent in the Chapters dealing with Indian Industry and Agriculture. The phenomenal rise in the price of cloth is an outstanding example of the effect of shortage on prices. The following table gives

the relevant figures *

(In millions of yards)

Year.	Domestic Mill production.	Net Imports + or Net exports. –	Government purchases.	Balance left for civilian consumption.
1938-39	4269	+ 365	—	4634
1939-40	4013	+ 220	300	3933
1940-41	4270	— 108	600	3562
1941-42	4494	— 805	1000	2689
1942-43 (estimated)	3900	— 1150	1200	1550

In addition to this 67% fall in the quantity of mill-produced cloth available for Indian civilian consumption there must have been a substantial fall in the quantity of hand-loom woven cloth as well, judging by the decrease in the quantity of yarn, both foreign and domestic, available to the weaver. Thus, e.g. imports of yarn had fallen from 41.1 million pounds in 1939-40 to 4.8 million pounds in 1941-42, while exports

* Taken from a memorandum submitted by the Federtion of Indian Chambers of Commerce and Industry to the Commerce Member, Government of India. and dated 22nd December, 1942.

of Indian yarn rose during the same period from 36.9 million pounds to 57.2 million pounds. Evidently therefore, the cloth shortage in the country is even greater than that indicated only by an analysis of mill cloth figures. There were similar shortages in a number of other manufactured commodities, particularly in those of foreign origin. This shortage would have brought about a rise in the price level even if there had been no Government created additions to the volume of currency. To argue that there can be no rise in prices without a prior rise in the actual volume of legal currency or to deny the effect of shortage as a contributory factor towards raising the price-level is to ignore the developments in modern monetary theory and particularly of the refinements introduced in recent times in the monetary theory of prices. The effect of shortage in any one commodity is admittedly to raise its price; it may be argued that, without an increase in purchasing power, this would automatically reduce the price of another commodity and that therefore there would be no rise in the general level of prices. This argument would be perfectly valid, if the shortage in question with its effect on the price of the commodity concerned were to be accompanied not by

an increase in purchasing power but by the individual diverting the impact of his purchasing power from other commodities to this commodity. But if the individual in question did not effect such a diversion, but kept on his present level of purchases of the commodities not subject to shortage and found the increased purchasing power required for the shortage-commodities either by reducing his savings or by selling his investments, it would result in an increase of total spending and therefore lead to a rise in the level of prices; this increased price level would automatically bring about an addition to the quantity of money. There is no doubt that this has actually happened, at least to some extent, as far as the urban middle classes are concerned. The increase in the price of cloth—the connection of which with shortage can be denied by no one—has not diminished middle class spending on other commodities; and it is not only cloth which is in shortage, but a number of other commodities as well. The result has been dis-saving, dis-hoarding and deficit-budgeting on the part of the urban middle classes and consequent increase in total purchasing power and total spending caused not by war finance, but by shortage resulting

from the war and the low industrial potential of India. The rise in prices is of course sustained by an addition to the volume of currency, but it is not the immediate cause, at least to the extent to which shortage with their effect on individual prices have led to an increase in total spending. Mr. Birla, therefore, is not quite wrong when he attributes the recent rise in prices to shortages in commodities. [1]

There is also no doubt that a part of the explanation is psychological, especially that relating to hoarding. During the last two years

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1. Further support is lent to this contention by the fact that the shortages in cloth, rice, and imported manufactured commodities were largest during 1942-43, which is the very year when prices have been rising most steeply. Thus in 1942-43, the Burmese supply of rice was lost to India, the percentage fall in the supply of cloth available for domestic consumption was 67, while the country had actually a net export of manufactured commodities to the value of Rs. 30.1 crores in the first nine months as against a net import of manufactured commodities to the tune of Rs. 45.2 crores in the 12 months of 1938-39. Moreover, the effect of shortage in imported commodities, which is offset in the beginning by decumulation of stocks, begins to make itself felt progressively with every additional year for which the war lasts and thus helps to accelerate the rise in prices.

especially in 1942-43 there have been on the one hand attempts by traders to hold back stocks from the market, while on the other hand, well-to-do families in urban areas have been exercising pressure on the market by trying to build up stocks that will last them for one or two years. But this psychology has not been the creation of speculation and public ignorance about monetary matters nor can it be traced to speeches and statements on inflation as suggested by Dr. Nemenyi; in fact, these speeches and statements made their appearance only late in 1942, by which time the rise in prices had already assumed alarming proportions. The emergence of black markets with its reaction on the psychological stimulus to hoarding was the direct result of the ineffective and ill-planned policy of price control of foodgrains which Government had instituted in 1941. The confusion was made confounded by the lack of central control and the indiscriminate and uncoordinated manner in which provincial Governments, Indian States and even district officials set about fixing prices and regulating the export and import of foodgrains in the areas under their jurisdiction. There is no point in dilating upon the shortcomings of the policy of control of food prices instituted by

Government, for Government has itself admitted the failure of this policy, and price control measures have now been largely withdrawn; but while they lasted, these measures provided a powerful stimulus to hoarding. The shortage of transport and uncertainty of commodity movement also played their parts in stimulating the psychology of hoarding; nor must we ignore the effect of rising prices in inducing hoarding on the part of producers, traders and consumers by creating in them the expectation that prices will rise still further. In short, psychological factors cannot be regarded as the originating cause of the recent rise in prices; but they certainly are important as accelerating causes and have undoubtedly contributed to the upward movement in prices.

The monetary factor has really been of the largest significance in bringing about the rise in prices. To say, as Dr. Nemenyi does, that the increase in the volume of currency has been according to law and therefore it was quite normal is to miss the whole point of the monetary significance of inflation. It is well known that as long as the increase in the volume of currency is not in response to nor accompanied by a corresponding increase in the volume of consumable goods, saving being constant,

it is bound to have an inflationary effect on prices, whether the note issue is backed by assets or not. Of course when the increased note-issue is not backcd by real assets, the position is worse, for it creates lack of confidence and thus psychological factors add their influence to the monetary effect of increased currency on prices and lead to a flight from currency into real goods. But even if the assets are there the monetary effect of increased currency is also there, so long as there is no increased production of consumable goods or increased reduction in consumption by a rise in savings. In fact, during the last war, prices rose both in Sweden and in the U. S. A., in spite of a 100% gold backing for their increased currency issues; and they were bound to do so. The argument that that the increase in Indian currency was quite legal therefore can afford no answer to the plea that this increase was responsible for the rise in prices.

The other argument that has been used to counter the monetary thesis regarding the rise in prices is the increase in liquidity preference. The Finance Member has pointed out that there has been an increase in the hoarding of rupees, while Dr. Nemenyi has drawn attention to the need for taking into account the pre-war rupee circula-

tion and not depending merely upon the volume of the note issue in calculating the percentage rise in the volume of currency in circulation. Dr. Nemenyi's point is sound, but we have already seen that even if we take into account the rupee circulation in August 1939, there has been a substantial increase in the volume of currency—both rupees and notes—in circulation, the percentage rise being as much as 176.[1] As for rupees being demanded for hoarding purposes, we have also seen that this is not quite accurate, as the net absorption of rupees, even after rupee coins became largely replaced by rupee notes, did not decline and actually showed a steep rise in the first nine months of 1942-43. There is admittedly an increase in cash holdings, but this does not explain away the effect of increased currency on prices; on the contrary, it is more likely to be a natural result of the rise in prices. Great play has also been made of the fact that the ratio of cheque clearings to bank deposits has fallen and from this the inference has been drawn that the newly created money has become sterilised and could therefore have had no effect on prices.[2]

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1. Vide Chapter VII, The War and Indian Currency.
2. This point figures in the Budget Speech of the Finance member and has also been made by Mr. Birla in his "Scarcity or Inflation" and by Sir C.B. Mehta in his presidential address to the 32nd Annual Meeting of the Bombay Shroffs Association.

But this is not a legitimate inference. It would have been correct only if there has been a decline not only in the rate of turnover of bank deposits but also in the total volume of cheque clearings. But in fact the volme of cheque clearings in 1942-43 shows a rise of 22% over the corresponding figure for 1939-40. There has been, therefore no freezing of additional bank deposits to the extent of their having no effect at all on prices. As for the fall in the turnover of bank deposits, it is perhaps an indication of the fact that cash is playing a much more important part in India's economy today than credit and that the additional cash currency, while exercising a full effect on the price level, has not led to that increase in general productive activity which usually accompanies and tempers a rising level of prices and gets reflected in the volume of banking business. There is no doubt however that bank money has not shown anything like the expansion seen in the volume of cash currency. This only proves the absence of a credit inflation in India. In western countries where bank money is quantitatively more important than cash money, inflation shows itself in the form of a rise in bank deposits accompanied by a rise in the ratio of their turnover. But in India, where cash is more important than bank money, figures of the movement

of bank deposits do not have the same monetary significance, particularly in the negative direction. All that the figures prove is that banks have not taken advantage of their increased cash holdings to embark on an inflationary credit policy. But while this failure of bank deposits to exercise more influence on prices is a matter for satisfaction, it can be no ground for holding that the increase in the volume of cash currency in India has had no relation to the rise in the general level of prices.

The third explanation viz. that the rise in prices is due to monetary factors has already figured in some previous chapters, especially in chapters VII and VIII. But it is not possible for the present writer to accept in toto the inflationist explanation as propounded by its leading exponents. It is important to emphasise that the rise in the volume of currency which is taking place today is not of the same type as took place in central Europe during and after the last war. Inflation of the type which took place in those countries was definitely the result of unbalanced budgets and meant the use of the printing press to finance governmental expenditure and the expansion in their note issues was naturally not accompanied by any corresponding movement in the assets—in gold or foreign exchange—of the

Central Banks concerned. In the case of India the deficits caused by her own war expenditure were, as were seen in chapter VIII, more than amply met from internal loans; while the expansion which has taken place in the volume of Indian paper currency has been accompanied by an equivalent expansion of sterling assets excepting for Rs. 160 crores against which only the backing is of *ad hoc* rupee securities. Even in regard to these *ad hocs*, it must be remembered that they are not *ad hocs*, in the ordinary sense but represent a cancellation of an equivalent amount of India's sterling debt and really constitute a "block of investment waiting to be taken up by the nation for which it has been acquired." [1] The present writer cannot therefore accept the statement that "the inflation in India is a deficit-induced, fiat-money inflation." It is not a fiat

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1. The position was thus explained by the Finance Member in his last Budget Speech. "At no stage of the repatriation programme has there been any expansion of currency against the *ad hoc* treasury bills created. These treasury bills merely replace the sterling against which currency had already been expanded in the ordinary course in order to meet legitimate demands for the means for making cash payments, and the substitution merely amounts to a readjustment of the assets of the Reserve Bank's Issue Department" p. 22.

money inflation, because behind the increased currency there are increased assets. It is not a deficit induced inflation because even if the finding of rupee finance for His Majesty's Government had not been undertaken by the Government of India, the expansion of currency would have taken place as long as the rupee remained linked to sterling and the Reserve Bank was under a legal obligation to purchase in unlimited quantities any sterling that was offered to it for sale at the statutory price.[1] Moreover, all the expansion which has taken place in Indian currency has not been due to the use of the currency mechanism for providing rupee finance for His Majesty's Government. As we have already seen, a part of it was the result of the favourable balance of trade on private account which could not be liquidated because of the difficulties—both natural and created by import control—of getting imports. Under the circumstances, it is in the best interests of the country that language of a type which is likely to create panic among the ignorant should not be used, particularly when the situation does not warrant it.

While denying that the rise in Indian prices

1. This point is discussed in greater detail in Chapter VII.

is the result of "a deficit-induced, fiat-money inflation", it is not possible to deny the obvious connection that exists between the rise in prices and the enormous increase in purchasing power brought about by the sale of goods and services to His Majesty's Government, and to private consumers abroad. We have already explained how this new purchasing power has been largely an *addition* to the total purchasing power in the country, and *not a transfer* from existing purchasing power; and we have also seen that due to the inability or unwillingness of the Indian public to subscribe to rupee loans sufficient to finance His Majesty's Government's rupee requirements, the necessary additional purchasing power has been created through the currency mechanism by additions to the volume of Indian currency. At the same time, this increased purchasing power has not been accompanied by an increase in the domestic supplies of consumption goods; on the contrary, accompanying the rise in purchasing power there has actually been a reduction in the supplies of consumption goods available for the civilian population. The result was inevitable; the rise in prices is the direct result of the increased purchasing power impinging upon a diminished volume of consumption goods and this rise in purchasing power was brought about by additions in

the volume of Indian currency.[1] There is, therefore, no doubt there is a causal connection between the rise in prices and the increase in the quantity of money. In other words, the rise in prices has a very large monetary explanation and can therefore be described as inflation.

The inflationary character of the rise in prices is further evidenced by the rise in the the cost of living that has accompanied the rise in prices. Figures of cost of living indices are prepared for about 30 centres in the country;

1, Mr. Birla, who denies the inflationary aspect of the present rise in prices, has himself given away his case in the following words: "The Allied Nations are drawing upon Indian resources to the extent of Rs. 25 crores a month or Rs. 300 crores a year. The purchases made on their account are spread all over the country and the transactions relating thereto are numerous and at times too small...... The figures establish a direct connection between Government's purchases and the rise in prices. It is the increased volume of Government's purchases, not the potential purchasing power of the people, that is responsible for the high price levels."—pp. 14-16: "Inflation or Scarcity". The relevant question which Mr. Birla does not answer is as to whether the additional purchasing power used by Government came as a transfer from the people or was newly created for the purpose of finding rupee finance.

for 15 centres, these details are available from August 1939, and if one takes the average of all these index numbers to represent the general rise in the cost of living in the country, with August 1939 as base, there has been a rise of 80 points in the general index of the cost of living by August 1942. Details are given below :

Centre.		August 1939	August 1940	August 1941	August 1942
Bombay	..	100	108	123	160
Ahmedabad	..	100	107	126	170
Sholapur	..	100	104	119	159
Nagpur	..	100	111	125	183
Jubbulpore	..	100	177	151	202
Patna	..	100	118	131	191
Muzzaffarpur	..	100	107	128	154
Monghyr	..	100	107	133	176
Jamshedpur	..	100	108	134	207
Jharia	..	100	108	135	193
Cuttack	..	100	118	144	192
Ranchi	..	100	102	130	198
Madras	..	100	110	118	140
Lahore	..	100	101	118	177
Cawnpore	..	100	112	130	203
Average	..	100	109	129	180

An increase in purchasing power, if it is not to be inflationary, must be accompanied either by a rise in the production of consumption goods

or an increase in saving; otherwise it results in a rise in wholesale prices and a rise in the cost of living. The rise in the prices of raw materials and primary commodities leads to an increase in the cost of production; therefore to a further rise in prices, therefore to a further rise in the cost of production and so on, *ad infinitum*. Similarly, the rise in the cost of living leads to a demand for increase in wages and grants of dearness allowances; this, in turn, leads to an increase in wage-costs and therefore to a rise in the cost of production; this grant of additional purchasing power to labour leads to a further rise in prices and in the cost of living, a further rise in wages and dearness allowances, a consequent rise in the cost of production and in prices and so on, *ad infinitum*. It is this which is called the inflationary spiral; when this tendency accompanies the increase in the volume of currency, it is called an inflationary rise. And this is exactly what has happened and is happening in India. The rate of dearness allowances sanctioned has been constantly rising, both in industrial establishments and in governmental services. So has been the rise in the prices of raw materials. And every such rise contains within it the seeds of a further rise. It is not possible to calculate accurately the increase

in purchasing power due to the grant of dearness allowances. But leaving aside the increase due to increased employment, it can be estimated on a conservative basis that the wages and salary bill of the low-paid employees has increased by about Rs. 30 crores in 1942-43 over its pre-war total; when it is recalled that this increase is transformed into effective purchasing power and has its full impact on the restricted supplies of consumption goods available in urban areas, there is no denying its inflationary influence.

The effect of the higher prices of raw materials and primary commodities in pushing up the money levels of war expenditure and of the rupee finance required by His Majesty's Government is also an important inflationary factor; for every such rise leads to an increase in tke volume of money and a further increase in prices. That this factor has also been operating in regard to war expenditure is clear from the following table dealing with lump sum provisions for increase in prices made every year over the normal cost of the defence services in 1939-40.

(Figures in lakhs of Rs.)

		% of basic budget.
1940-41 (Accounts)	1,38	3.8
1941-42 (,,)	3,20	8.7
1942-43 (R. E.)	7,42	20.2
1943-44 (B. E.)	9,43	25.6

If the same percentage rise could also be applied to the War Emergency expenditure on defence, more than Rs. 38 crores of this expenditure for 1943-44 would be due to the rise in prices ; if the same percentage be applied to the rupee expenditure incurred on behalf of His Majesty's Government in India for 1942-43 (those for 43-44 are not available), the extra expenditure incurred on account of rising prices would be more than Rs. 80 crores. It will be seen therefore that the inflationary spiral is already at work and increasing the money total of war expenditure. It must also be remembered that the rise in the cost of living is increasing the real burden of the war for the people to an extent greater than the actual war expenditure ; further, the rise in the cost of living is affecting different classes of people differently and is hitting particularly hard the people with fixed incomes. It is therefore both in the interests of the Government and the governed, including His Majesty's Government, that immediate steps should be taken to counter this inflationary tendency.

How can this inflationary tendency be arrested? The problem has to be attacked from five angles :

1. Supplies of consumption goods available to the country should be increased to the

maximum possible extent. This will include both domestic production and imports.

2. The increase in purchasing power due to war expenditure (of both the Indian and British Governments in India) should be frozen and diverted from consumption goods into Government loans and taxes or any other non-spending channel to the maximum possible extent.

3. The cost of living should be stabilised and rationing introduced with a view to securing equitable distribution of consumption goods according to need and not the size of individual incomes. This is required only for urban areas and would enable the imposition of ceilings on wages, dearness allowances and dividends.

4. The increase in purchasing power itself should be minimised. This can be done either by reducing our exports on private account or increasing our imports on private account or diminishing the Indian Government's war expenditure or diminishing the purchase of supplies in India by His Majesty's and Allied Governments.

5. The psychological stimulus to hoarding should be attacked and overcome. This would be accomplished largely by undertaking the counter-inflationary measures mentioned above. A direct attack should also be made by making hoarding of goods both unattractive and dangerous in the case of traders and consumers, and in addition, by providing alternative channels of investment or hoarding for the agricultural producers.

How far these measures are practicable and what should be done to make them more practical are matters which are discussed in a separate chapter. It is sufficient to note here that the measures suggested above are in principle largely identical with those suggested in the statement issued by the twenty Indian economists, though it must also be added that there are differences in detail, particularly with reference to practical enforcement, between the present writer and the twenty distinguished economists.

We have now completed our analysis of the effect of war on various aspects of Indian economy. In the next chapter, we proceed to summarise and examine as a whole Government's war-time economic policy.

CHAPTER X.

WHAT GOVERNMENT'S WAR-TIME ECONOMIC POLICY IS.

What has been Government's economic policy during the war? It must be stated at once that there has been no comprehensive statement of economic policy on the part of Government; from time to time, a number of declarations have been made concerning different branches of economic activity in the country such as exchanges, trade, transport, industries, prices, etc. but there has not been a statement of what one may call a total economic policy. We shall therefore set out our own formulation of what Government's total economic policy has been on a review of what they have actually been doing with regard to different branches of economic activity in the country.

To begin with, Government's policy regarding foreign exchange was one of control with a view to the conservation of exchange resources. We have already seen that this policy was not in the Indian civilian interest as it accentuated the problem of scarcity of domestic supplies; but it was in keeping with the policy of the British

Government to conserve the Empire's exchange resources and utilise them for the maximisation of war supplies from non-sterling countries. Similarly their policy regarding foreign trade was one of controls, aimed at an active discouragement of imports by the civilian population; there was no similar discouragement of exports, the main object of export control being confined to seeing that exporters to non-Empire countries got paid in "hard currencies" and transferred the same to the British banks in return for sterling. This again resulted in an accentuation of the problem of scarcity of domestic supplies, but was helpful to the war effort from the point of view of the British Empire. Similarly, regarding transport, the policy was one of priorities and permits which facilitated the movement of military traffic, but resulted in a contraction of the transport facilities available for civilian purposes. Generally speaking, Government's policy regarding trade, transport and exchange has been mainly directed towards furthering the war effort of India taken as a unit of the British Empire; and not much attention has been paid to meeting the reactions of this policy on the civilian population.

The policy regarding production was also similar. We have seen in Chapter V that Gov-

ernment did not worry about the production of foodgrains in the country till two years after the outbreak of war; and even then, beyond a publicity campaign of "Grow More Food", they did not take any active steps to increase the production of foodstuffs. This was perhaps because the reduction in domestic supplies consequent on the war and the increase in domestic demand due to increased employment and higher wages in the country did not come in the way of their getting as much foodgrains as they wanted for military requirements both in India and abroad; but this policy soon led to difficulties on the civilian front; and Government has now, in the fourth year of the war, created a Food Department to deal with the problem; even now, Government's food policy is more concerned with trying to secure better distribution than actively increasing the food supplies.[1] As regards manufactures, also, again, Government's policy has been mainly one of looking after military requirements, without paying much attention to the reactions on civilian supplies. Thus e.g., in regard to cloth, Government have obtained from the textile industry as much supplies as they required for their military requirements; they

1. Vide the recent broadcast by Major-General Wood, Secretary of the Food Department.

have also permitted a large export of Indian cloth to meet civilian demand in allied countries in the interests of the war effort of the United Nations; the reaction of these measures on cloth supplies available for civilian consumption in India are well known and have been dealt with in detail by us in Chapter IX; it is only recently that Government have taken adequate note of these reactions and are attempting to organise the production of "Standard Cloth" that will help to meet our civilian requirements; even here, the movement is in the direction of redistribution rather than of a large-scale increase in supplies. Regarding a number of articles required for military use like cement, petrol, rubber tyres and other rubber goods, iron and steel and even bricks, severe restrictions have been imposed on civilian consumption, but no active attempt has been made to increase domestic supplies. Everywhere, the civilian has been left to fend for himself and scramble for a share of the restricted supplies by paying higher prices; and the natural effect of higher prices in bringing about increased output has been prevented from operating by restrictions on the expansion of industrial capacity and on the import of machinery and machine tools required for the purpose. No attempt has been made in the country to set up

the vital war factories that could also have strengthened the country's basic industrial position such as automobiles, aircraft, shipbuilding, locomotives and heavy chemicals. The controversy between Mr. Walchand Hirachand and the Government of India regarding the unwillingness of the latter to help in the establishment of the automobile industry in the country is well known; and it is clear from a perusal of the statements and counter-statements issued on the subject that, given the will on the part of the Government, much of the difficulties could have been smoothed away. The attitude of the Australian and Canadian Governments and the manner in which they have helped to establish the heavy engineering industries in their own countries constitutes a painful contrast to the attitude of our Government. It is only in the field of munitions and ordnance factories that Government have taken a direct hand in increasing production; and it must be admitted that they have succeeded here admirably. Even the Board of Scientific and Industrial Research has had to concentrate its attention on war problems and civilian requirements have largely been outside its purview. As far as increasing civilian supplies by increasing total supplies is concerned, very little has been done by Government.

The same one-track mind is seen in Government's attitude to prices. They instituted price control in the case of a number of primary commodities, but the control was effective only as far as military purchases were concerned. As for the civilian population, the main result of of the price control was to create black markets where prices were very much higher than controlled prices; and it led to hoarding on the part of traders and abnormal demands on the part of well-to-do consumers which only worsened the situation. Government has now removed its price controls, but that has not solved the problem either, for prices are now high legally instead of illegally. Price control, without control of supplies, without a centrally directed policy, without rationing, and without checking the recurring weekly additions to the volume of currency, was bound to fail. Now that Government have realised the military importance of civilian food supplies, we see the beginnings of a vigorous attempt at dealing with the civilian aspect of the food situation.

Similar exclusive concentration on military factors without attempting to deal with their reaction on the civilian problem has also been shown by Government in their tackling of the

question of financing the war effort. They have followed, as we have already seen, the easiest method of financing the war effort by receiving payment in sterling and getting it converted into rupees, even though this meant a recurrent addition to the volume of Indian currency with its inevitable inflationary consequences. They have still not taken active steps to counter this inflationary tendency even though it is causing their money bills of war expenditure to rise, because it is the easiest way to get the rupee finance needed for their war effort. But its consequences for the civilian population are daily increasing in their menace and after a time they will begin to affect the war effort.

Finally, the absence of a popular basis for the Government of India deprives the country of that tremendous psychological stimulus to raising the national curves of willingness to work and willingness to save which is present in other wareconomies. If output of work or saving be measured on the vertical axis and rates of remuneration on the horizontal axis, then the psychological stimulus afforded by a people's war would be seen in a raising of this curve; if, however, output of work or saving is measured on the x axis and rates of remuneration on the y axis (as is more usual), the psychological stimulus

would show itself in a shifting to the right of the curves of willingness to work and to save. In either case, they will represent a state of affairs where, rates of reward remaining constant, more work or saving is available than before at any given rate. This would naturally keep down the money costs of war expenditure, as compared to a situation when there is no such psychological stimulus, and therefore for getting more work or saving one has to move up the curve *i.e.*, increase the rates of remuneration. In India, the incentive employed for obtaining the personnel, goods and finance required for the war effort has been largely the money incentive. Thus, scales of pay in the armed forces are fixed substantially above the civilian earnings of the recruits; salaries in the special departments of Government engaged in war work are fixed at levels much above the previous or alternative earnings of the officers recruited; dearness allowances are granted to railway workers, postal and telegraph workers and low paid Government servants to counter their dissatisfaction with the rising cost of living; and the Excess Profits Tax is kept unincreased at $66\frac{2}{3}\%$ to retain the businessman's interest in expanding war production. This use of the money incentive not only results in a higher total

of war expenditure but also helps to raise the level of prices in the country and thereby has an inflationary effect. In other war economies, the money incentive is used much more sparingly; and psychological stimuli are provided by appeals to the people's patriotism and idealism and are strengthened by the fact that the war is being waged by people's Governments. In this country, the authority conducting the war cannot be described as a people's Government. But even constituted as they are, it is possible for Government to create among the public a feeling of neutrality, if not one of active support, to their policy; this could have been done by associating with themselves leading representatives of popular opinion in the discussion and settlement of problems of economic policy. But beyond utilising the services of leaders of industry in export and import panels, the textile panel and the Board of Scientific Research, they have not cared to consult leaders of Indian opinion before coming to decisions. Not only is the civilian consumer represented nowhere, but even the industrialist has been left out in the settling of such important matters as the financial allocation of war expenditure between India and England, Lease-Lend Negotiations, International Conferences on food and monetary

policy and the activities of the United Kingdom Commercial Corporation. This last-mentioned body has been entrusted with the commercial operations connected with supplies to the Middle and Near East; and normal commercial channels of indigenous origin have been left in the cold. This has created great resentment in the Indian commercial community and has formed the subject of resolutions by the Federation of Indian Chambers of Commerce and Industry; but they have been of no avail as far as changing Government's policy in the matter is concerned.

This brief review of Government's present war-time economic policy shows the following salient features:

(1) No attempt has been made to any significant extent to increase the totality of resources effectively employed in the country except in the matter of munitions production and defence services. The result is the continued existence of substantial unemployed and under-employed resources in the country.

(2) Existing effectively-used resources, which were already low enough from the point of view of the country's do-

mestic requirements, have been diverted in substantial measure from the production of consumption goods available for domestic civilian consumption to the production of consumption and non-consumption goods required for military and allied purposes. This diversion has been accomplished by the use of controls over trade, transport, exchanges, raw materials and industry and by additions to the volume of currency.

(3) The controls referred to have created shortages in the country; and these reductions are made from a supply already low even from the standpoint of giving the people the minimum necessary physical standard of maintenance. The result has been scarcity for the civilian and rising prices. Simultaneously, purchasing power in the country has been enormously increased, and all attempts to freeze this increased purchasing power having failed, its impact has been felt in full by the diminished supply of civilian goods and led to a steep rise in prices. The result is an inflationary situation which is already

assuming the form of a spiral.

(4) The incentives employed are mainly monetary with the result that the inflationary tendency created by the war effort is thereby strengthened; public opinion is not consulted in important issues of policy and even the leaders of Indian Commerce and Industry are given no say in the determination of important economic issues vitally affecting their interests.

One can sum up the situation briefly by saying that Government's war-time economic policy has been one of low production, high degree of scarcity for the civilian population and the use of inflationary methods for obtaining the bulk of the rupee finance required by His Majesty's Government. Scarcity for the population, it may be said, is common to all war economies. That is quite true; but the significance of scarcity and tightening the belt becomes quite different when one starts from an already nearly empty stomach; it gets a new meaning when full use has not been made of the available resources of the country in men and raw materials; and it becomes difficult to endure when the scarcity has been brought about not only by the direct methods

of taxation and controls but also by the indirect method of inflation, with the result that the incidence of scarcity is spread unevenly over the different classes of population. This is the vital difference between the scarcity of consumption goods that is the result of India's war economy and the scarcity that is the result of Britain's war economy. The British people know that everythig possible has been done to maximise their production ; they also know that the reduced supply left for their consumption is distributed equitably according to need and not according to money power. Above all, they know that their war economy is administered by their own elected national government ; and the psychological compensation resulting therefrom is a big set-off against their physical deprivations of goods and services ; and the real costs of war economy are therefore correspondingly reduced for them. The cardinal feature of our war economy has been the transfer of resources from civilian to military purposes ; this it has in common with other war economies. What it has not in common with others but can claim as its own peculiar features are the absence of an attempt at total mobilisation of resources, and an inequitable and arbitrary distribution of the incidence

of the transfer of existing resources from civilian to military uses. The additional real cost of our war economy resulting from these factors is heightened by a lack of the psychological compensations that accompany a people's war that is waged by a people's government.

But mere criticism will not serve any useful purpose. It is the duty of the critic also to suggest remedies. We turn therefore in the next chapter to a statement of what we think should be the country's war-time economic policy.

CHAPTER XI.

WHAT GOVERNMENT'S WAR-TIME ECONOMIC POLICY SHOULD BE.

The proposals that we make below are not intended to be a dogmatic assertion of policy. They are only tentative suggestions, subject to modification in the light of further experience. It must be added, however, that these suggestions are based on an attempt to apply the political economy of war to the peculiar conditions of Indian economy; and they are framed in the light of our analysis of the impact of total war on Indian economic life.

The political economy of war requires three basic conditions for success:—

(1). Total mobilisation of resources. Production must be at its maximum and there should be no unemployed or under-employed resources.

(2) The diversion of resources from civilian to military use must be effected in such a manner that

(a) it does not involve the use of inflationary methods with their arbitrary and inequitable distribution

of the war burden but falls primarily on those who are either able or willing, even if not able, to suffer this reduction in their standards of life;

(b) it is not accompanied by a substantial rise in the cost of living;

(c) it is accompanied by an equitable distribution, on the basis of need, among the civilian population of the diminished supply of goods available for their consumption.

This means war finance by taxes and loans, accompanied by price control and rationing.

(3). The resources diverted for military purposes should be efficiently organised and put to the most effective use. In other words, the resources employed for different military purposes must be in such quantities as will secure their equi-marginal productivity from the point of view of the war.

The last condition is one which can be decided only by those with informed military judgment and complete knowledge of military production. But the other two conditions fall within the economist's purview and form the basis of our proposals.

There is one condition we must take into account in view of the peculiar state of Indian economy. The nation's normal production of consumption goods and services in the pre-war period has been so low that the margin for transfer to military use is also very low. Under the circumstances, Indian war economy should be concerned not so much with transfer of existing resources as with increasing the quantity of total production; and the vast resources of the country in terms of raw materials and labour make this also possible, given the necessary equipment and organisation. The Indian war economy requires more attention to be paid to the civilian and his requirements than is necessary in the case of the war economies of other countries ; and it is the cardinal defect of the war-time economic policy of the Government of India that they have not perceived this basic truth. Our Government have proceeded to plan our war economy on the simple basis that all that is required is a transfer of resources from civilian to military use ; they have forgotten that in India, increase of resources for military purposes can be safely accomplished only with a simultanenous increase in the production of consumption goods (or what are technically called wage-goods). It is

this failure to perceive the peculiar importance of civilian supplies that is responsible for most of the weaknesses of our war economy.

We can now proceed to state what in our view should be the war-time economic policy of the Indian Government.

First, production should be maximised; unemployed and under-employed resources should be fully utilised; and substantial increases effected in the supplies of civilian consumption goods or wage-goods as they are called in text-books of Economics. This can best be done by the creation of a Department of Production, which should include in its scope all wage goods and not merely food. This department should have as its primary object increase of the production of foodgrains, cloth and other articles of general consumption by the masses of the people, including medicinal goods like quinine and anti-epidemic drugs of different types. It should also be concerned with increasing the production of transport equipment and fuels without which increased production of goods is not equally useful to different parts of the country. The increase in supplies should be effected not only by expanding domestic production with the help of domestic equipment but also by the help of imported equipment;

and where this is not possible, by supplementing domestic supplies by imported supplies. In concrete terms, production of foodgrains can be increased either by subsidising food production or by artificially depressing prices of non-food crops or by providing better seed, ample manure etc. to the cultivators and thus help them to increase the yield per acre. Government can also help to bring new land—according to the statistics published by the Government, the cultivable but uncultivated area in the country was 97.2* million acres in 1939-40—under cultivation bv offering substantial concessions in respect of taxes and providing farmers with the initial capital necessary for the purpose. Well irrigation should be encouraged by Government providing a substantial share of tbe costs involved. Artificial manure should be given import priority and obtained as quickly as possible because use of artificial manure is the quickest way of increasing food supply in the short period without creating any disturbance in the economy of the country. We would suggest that imports of artificial manure should be undertaken by Government itself and distributed

* Out of these only 10 million acres are definitely known to be cultivable.

to food-crop areas at nominal prices. Food growing should also be made attractive by guranteeing State purchases of all surpluses at fixed rates: and the growing of food crops may also be subsidised by giving revenue concessions on every acre of land that is converted from cultivation of non-food crops to that of food-crops; to prevent any undesirable repercusions of this on the existing areas under food crops, penalties may be imposed on every acre of land that is withdrawn from cultivation of food crops. It is also posible to make the cultivation of food crops attractive in other ways. There is no reason why the stimuli used should not be in the nature of a collective appeal to village interests. Thus e.g., villages which will increase the proportion of their area under food crops could be promised collective amenities at Government expense in the form of provision for the supply of pure drinking water or construction of roads or other requirements of the village population. In any case, what is required is not merely a redistribution of available food supplies but a substantial increase in its total volume; and this cannot be done merely by sentimental appeals to the cultivator to grow more food.

The other important item of civilian supplies is that of cloth. Here again, the policy should not be merely one of reallocation of existing supplies in favour of the civilian—though this is also necessary—but should include the increase of production. It may be difficult to get supplies of textile machinery, though it is not impossible if military priority is given to that volume of machinery which is required to meet military requirements of cloth.* But there is an easier method available if only Government will take advantage of it. The country has a large number of handlooms which are lying idle; at the same time it has large supplies of surplus cotton. If only this cotton could be spun into yarn, the yarn could be woven into cloth on the handlooms. The texture may be uneven and the quality rough but it will be better than having to go without cloth. It is possible to do this if Government could take interest in the promotion of handspinning. The country has an organisation which has specialised in the production of handspun hand-woven cloth, *viz*, the A.I.S.A;

* In this connection, it is interesting to note that a complete set of textile machinery was specially made in England and exported to Australia to manufacture cloth for the use of troops stationed in Australia.

and its pre-war annual production was in the neighbourhood of 20 million yards. Given Government help and financial assistance, this output could be increased several-fold but the necessary assistance is not forthcoming from Government. On the other hand, the A,I.S.A. has been treated as a political organisation, many of its active workers are under detention, aud a large number of its centres have been closed under Government orders. If only this policy is reversed, and the A.I.S.A. allowed to function not only unhindered but also actively assisted by the Government, it can do a good deal to increase the production of cloth in the country and thus help to meet the problem of shortage. In addition to increasing the total supply in this manner, a much larger share of the supply should be reserved for domestic civilian use. This can be done by drastically curtailing, if not stopping altogether, exports of yarn and cloth on private account; and by exercising rigorous economy on the cloth requirements of both the Indian and British Governments.

As regards other manufactured goods, it is not possible to discuss their position in detail. But the general policy should be one of increasing the country's industrial potential so that the

shortages experienced in numerous lines of civilian supplies could be overcome; for this, it is necessary to revise our policy regarding both exports and imports. Exports should be minimised and imports should be maximised. I know that the availability of imports depends much more upon the British and American Governments than on our own; and these Governments will not be willing to render assistance in the matter of our getting imports unless the imports are linked up with the war effort. Here it is that a correct understanding and exposition of our war economy should come of use. The Allied Governments must be made to understand that India's war effort cannot continue to be financed merely by drawing upon her existing productive resources which are too low even for securing minimum civilian supplies; and that the consequences of doing so on civilian economy and civilian morale are not only an increase in the money bill of war expenditure but also will prove injurious to the war effort itself. In an industrial sense, India can well say 'Give us the tools and we will furnish the United Nations with all the supplies they need without at the same time starving India's own civilian requirements;" but she must be given the necessary tools which means machinery and

equipment and this can be done only if the American and British Governments will to do so. If once the Allied Governments understand this peculiar nature of Indian Economy, I have no doubt that they will provide facilities for the import of equipment that will help to raise India's industrial potential, increase her output of both consumption and non-consumption goods and make them available to all the parts of the country.

With all this increase in production, however, civilian supplies will be less than their pre-war levels; and it is also natural that it should be so during times of war. At the same time it is not possible to diminish to any significant extent the rupee expenditure now incurred on supplies for the Indian and British Governments. If this increase in the volume of purchasing power is allowed to impinge on the diminishing volume of consumable goods, it is bound to lead —as it has been doing—to a rise in prices, an increase in the cost of living and the emergence of an inflationary spiral. If this is to be avoided, the following measures are necessary.

As much as possible of the increased purchasing power required by Government should be obtained by transfer from existing purchasing

power and not by additions to it. This should be done by means of loans rather than by taxes, as the increased purchasing power is required by the British Government and has behind it the backing of sterling securities. It is necessary therefore that more vigorous attempts should be made to raise loans. I have the strong conviction that the main weakness of the loan programme of the Government of India is the lack of a popular basis for its constitution; and that as long as this is not remedied, voluntary subscriptions to Government loans will never reach the levels they otherwise can; that is why I am not sure whether a rise in the rate of interest which is advocated by some people will accomplish its object of substantially increasing subscriptions to Government loans. Raising the rate of interest, will, of course, be in line with the policy hitherto pursued by the Government of India of using the monetary incentive to get the resources required for their war effort. But it will depress the security market, inflict undeserved losses on insurance companies and banks—which hold large portfolios of Government securities—and also on those private holders of Government loans who have stood by Government in their difficult times, increase the interest burden of our public debt and create difficulties in the post-war period;

and with all that, there is no guarantee that it will succeed in its object. In fact, as far as the Indian Government's loan programme with reference to its own war expenditure is concerned, there has been no difficulty in getting the amounts required at the existing rates of interest; it is the loan programme concerned with finding ing rupee finance for His Majesty's Government that is not receiving adequate public response. If it were possible to pay higher interest only on such loans, it may be considered; but this is impractical, as there can be no such water-tight division of the security market; and it is not fair that the Indian Government should be saddled with higher interest burdens because the people are unwilling to provide rupee finance for His Majesty's Government. I am convinced, therefore, that as far as voluntary subscription to war loans are concerned, the creation of a national government would be of far greater help than a rise in the rate of interest; and this would have the additional advantage of not only not producing other adverse effects, but will actually facilitate the smooth and efficient running of the war economy in all directions. But even with the existing Government, there is room for compulsory saving; and it is surprising that beyond a very faint-hearted attempt in the budget of 1942-

43,[1] nothing has been done in this direction. I would suggest that the principle of compulsory saving should be applied on a broad basis; and the rates of income tax and super tax raised substantially, the increased tax receipts being regarded as compulsory loans returnable with interest at the end of the war. If the Excess Profits Tax is not raised to 100% as a tax, it should at least be raised to that level as a measure of compulsory loan, thc excess over the present receipts at $66\frac{2}{3}\%$ being returnable with interest at the end of the war. Creation of new purchasing power can also be avoided by the reduction of sterling balances. This has been attempted by the repatriation of sterling debt, but has not fully succeeded in its objective, as a good part of it still remains financed by "Central

1. An option was given to new assessees for income-tax under the lowered exemption limit to escape the liability by depositing an amount approximately $1\frac{1}{4}$ times the amount of tax assessed in the Post Office Defence Savings Bank, such deposits not being ordinarily withdrawable till one year after the end of the war. Government also offered to contribute an amount upto one tenth of the net excess profits tax, provided that the assessee deposits a sum equal to double this amount, to a reserve to be used for the object of assisting industrial rehabilitation after the war.

Bank money", and is represented in the active note circulation. The Finance Member's proposals in his budget speech for the current year to utilise our sterling balances, to capitalise and pay off the country's sterling pension obligations, and to set up a Postwar Reconstruction Fund, do not involve repatriation in the present and will not result in a corresponding reduction in the additional rupee purchasing power which has been created against these sterling balances; as such, whatever be the merits or otherwise of these proposals in themselves, they provide no help in the task of transferring purchasing power from the public to Government for provision of rupee finance. This object could be achieved far more successfully if Government utilised the sterling balances for the repatriation of British commercial and industrial investments in India; this, of course. will not exhaust the sterling balances, but it will certainly help to reduce their volume and therefor also that of the additional rupee currency which has been created againt them. This course has been advocated both by economists and by the leaders of Indian commerce and industry, but curiously enough, it finds no mention whatsoever in the Finance Member's budget speech. It is interesting to note in this connection that for finding dollar

finance, repatriation of British private investments in America was undertaken on a large scale; but a similar procedure has not been so far employed for finding rupee finance in spite of the inflationary consequence in India accruing from the present method.

The measures suggested above, if carried out vigorously, will result in a substantial measure of the rupee finance required by Government being obtained by transfer from existing purchasing power and will therefore help to counter the inflationary effect of our war economy. But there will still remain a goodly share of purchasing power which is additional to the pre-war volume of purchasing power; and this will be an effective addition as it is mostly in the hands of of the poorer sections of the community. Some attempt will have to be made to draw away this purchasing power from the market for consumption goods. Several methods are possible, viz., (1) money payments for war supplies may be made partly in the form of war loans, realisable with interest at the end of the war; (2) a ceiling may be put on cash payments of wages and dividends, the excess above the cash levels considered desirable being paid in the form of war loans, returnable with interest at the end of the war; (3) cash certificates

payable in silver or gold at the end of the war can be sold in urban and rural centres, and issued in small units, subject to limits being placed on maximum individual holdings. This would take, to some extent, the place of treasure for the supply of which the country is starved and will be of great use particularly in preventing the rural population resorting to hoarding of commodities and thereby pushing up the price level : (4) the rate of interest on Defence Deposits in Post Office Savings Banks may be raised from 2½% at which it is fixed today to a rate well above the market rate, say to 4 or 5% ; the higher interest charges involved will not be very large if a maximum of Rs. 1,000 or Rs. 2,000 is placed on individual holdings ; but it will take away from the market a most active form of purchasing power ; (5) Finally, banks all over the country may be asked to open special fixed deposit accounts and, subject to a suitable maximum, offer a much higher rate of interest than they are offering today, the excess of this rate over their present rates being met by Government ; (6) Another method may be the issue of the usual Defence Loans to people with small incomes at a substantial discount ; and the clientele for this may be obtained from the depositors in Post Office Savings Banks ; here again, a maximum limit may be imposed on individual purchases.

All these measures will, in my opinion, help to tackle the problem of inducing the small man to part with his additional purchasing power. It is this which Government has most signally failed to do, the small man's investments in the form of Postal Cash Certificates and Postal Savings Deposits having actually recorded a fall during the war.[1] And unless the small man's additional purchasing power is effectively diverted from spending to saving, all the counter-inflationary measures suggested earlier in this chapter and also finding mention in the Indian Economists' Memorandum will not be of much avail; because a goodly share of the extra purchasing power created in the course of finding rupee finance for His Majesty's Government goes into the hands of the worker and the peasant; and if the worker and the peasant continue to spend this extra purchasing power, they will help to raise the price level and the cost of living without of course really benefiting themselves. That is why I attach the greatest importance to the need for wooing the small investor in any counter-inflationary

1. The combined total of Postal Cash Certificates and Savings Deposits recorded a fall of Rs. 53.3 crores by March 1943 as compared to their level in March 1939.

programme ; and the suggestions made above are designed from that point of view.

All the counter-inflationary methods mentioned above will not, however, create plenty where there is scarcity ; and if demand is left unchecked, it will result in the moneyed people grabbing the supplies and the poor people being left with less than their due share. There is also the danger of a rise in the cost of living due to the impact of the demand of the moneyed classes. That is why in all war economies, ceilings are placed on the prices of the main articles of consumption, and if necessary, their prices are kept low by subsidies ; ∞ and in addition, rationing is introduced by which the quantity of individual purchases is limited to individual needs and not left to be determined by the size of individual incomes if the quantity available is not sufficient to satisfy all individual needs. Both these things will have to be introduced in India. It is true that the

∞ Thus, e.g. according to a recent statement of the Chancellor of the Exchequer, the current retail prices in Britain are bread 9 pence per pound, sugar 3 pence per pound and potatoes 13.5 pence per fourteen pounds ; but without the subsidies, prices would be 11,5, and 15.5 pence respectively.

country is vast in area and rationing presents more difficult problems here than in the other Allied Countries ; but at the same time it must be remembered that it is not necessary to introduce rationing all over India. Rationing is really necessary only in the urban areas ; it is necessary in the rural areas, if at all, only in the case of cloth. The system can be carried out successfully only if all urban shops are licensed and there are central stores in each city from which the retailers can get their supplies. Individual consumers would get their supplies from the retailers at controlled prices on the production of their ration cards. The rationing may be restricted in the beginning to foodgrains, cloth and fuel; and in fact, that would meet the most urgent of the problems arising from scarcity. If centralisation of all supplies is secured by transport control and Government purchases in bulk, it would be easy to subsidise the retailers to enable them to keep their prices low ; in fact, the retailers could get their supplies from the wholesale stores at prices fixed by Government and permitted to sell these supplies after adding a percentage fixed by Government as the retailer's commission ; and the wholesalers, who would be subject to close control by Government if they are not actually employed as its agents would

be subsidised to the extent of the difference between the prices at which they sell and the prices at which they buy and allowed in addition a percentage commission for their own labour. This is how the cost of living is stabilised, and the available supplies of consumption goods equitably distributed among different consumers. This is what happens in other countries; and I see no reason why it should not be successfully done in India also. The urban population according to the Census of 1941 is only 50 millions; and the total number of towns is 2703. But more than 31 per cent of these 50 millions is found in 57 cities, and 12 per cent in 95 principal towns. If factories and other large employers, like Government, Railways and local authorities are entrusted with the task of distribution of rationed supplies to their own employees by the opening of special grain shops or such other methods as they may devise—in fact, this has already been started by Railways and and certain other large employers—, the position becomes easier, for the persons affected by this procedure form a large part of the urban population. The problem is, therefore, certainly not unmanageable. It will be seen that this system of control of the prices of the principal commodities is to be effected not by control of prices at the primary markets—which is almost impossible to

manage in a country like ours—but by bulk purchases by Government at the ruling prices in the primary markets and re-sale to wholesalers or retailers as the case may be in urban areas at lower prices, the difference being borne by Government. As for rationing of cloth in rural areas, a simpler methed may be followed ; ration cards not for quantities but for given values may be distributed through the revenue agency to every rural householder ; and quantities of cloth made available to each taluka at controlled rates and permitted to be sold only at those rates plus a defined addition to cover expenses. This may cause some inequality among rural households, as the average number of persons per household will not be identical with the actual number in each household ; but it will certainly be better than the existing system where a few men can hoard large supplies and leave the large majority completely without any supplies for even their bare necessities.

Above all, Government's war-time economic policy should be based less on the play of the money incentive and rest more on that appeal to the patriotism and idealism of the people which is the mainstay of the war economy of most of the Allied Nations. This can be done by an ending of the present barren political

stalemate and the institution both at the centre and in the provinces of National Governments broad-based on the support and active co-operation of the people. Such a step will help to ease many problems and steer the country clear from the inflationary dangers emerging in our war economy which, if left unchecked, would eventually prove ruinous to the success of the whole war effort itself. Given a National Government, propaganda by Government assumes a different role altogether and will become an effective instrument for regulating the people's lives and habits in accordance with the requirements of war economy. Loans will be better subscribed, hoarding will evoke more social wrath, more food will be grown and rationing and price control become easier of achievement. In short, a National Government will result in a raising of the national willingness to work and to save, and this will make all the problems of war economy more easy to tackle than they are today.

Finally, Government should begin planning from now its post-war economic policy. This problem is discussed in detail in the succeeding Chapter; but it is relevent to point out here that post-war planning can be successful only if it is undertaken by those, whose ears are close

to the voice of the people, and in whose ability and *bona-fides* the people have complete confidence. This again is possible only if the Government of the country is carried on by those who command the confidence of the people, *i.e.*, only by a National Government broad-based on the will of the people.

To sum up, Government's war-time economic policy should include the following salient features :

(1) Institution of a National Government.

(2) Expansion of industrial capacity, and increase of production of consumption goods and civilian supplies in general, in addition to military supplies.

(3) Obtaining as much as possible of the rupee finance required for the war by means of *transfer* of existing purchasing power and not by additions to it.

(4) Freezing of as much as possible of the additional purchasing power created by war finance by its conversion into savings.

(5) Stabilisation of the cost of living by subsidising urban supplies and equitable distribution of the restricted supplies by means of rationing.

(6) Attention to the problems of post-war economic policy.

In the next Chapter, we shall examine the probable effect of the war economy on post-war India and discuss the problems it will give rise to and the policies appropriate for tackling these problems.

CHAPTER XII.

PROBLEMS AND POLICIES OF POST-WAR ECONOMY.

It is not easy to say anything very concrete about India's post-war economy. Much will depend upon when the war ends and what will be the state of world economy in general when it does so. The constitutional position of India will also be a determining factor. Above all, our post-war economy will be shaped by what happens to the Indian Government's war-time economic policy, whether it will undergo all or any of the changes suggested in Chapter XI. Our remarks therefore will be based mainly on what has already happened, and when assumptions are made regarding the future, they will be clearly stated in the relevent context.

In order to know what the problems of Post-War economy are likely to be, it is first necessary to describe the changes in our economic structure brought about by the war. These changes have been discussed in detail in the preceding pages and briefly summarised below :—

(i) From the point of view of agricultural production, there has not been much

change, except perhaps a slight shift from the production of raw materials and non-food crops like cotton, jute and certain oil seeds to the production of food crops like wheat and rice. But there has not taken place on an appreciable scale either an increase in the area under cultivation or an increase in agricultural production. The cattle problem may be more acute, owing to the large slaughter of young cattle that is going on during the war. The position of the cultivator is likely to be better in so far as he has used his increased money income during the war to wipe out or reduce his indebtedness.

(2) As regards the production of non-agricultural goods, the war is bound to leave its trace. As far as the main pre-war industries like cotton textiles, jute, coal, tea, sugar and matches are concerned, the change in production is practically negligible. Some other pre-war industries, however, like iron and steel, cement, paper, woollen textiles, sulphuric acid, paints and products of breweries and distilleries have achieved some increase in output; while there

has been an appreciable increase in the number of small engineering establishments and in the variety and volume of work done by them. Ordnance factories have increased in large number and production of munitions, and army equipment like clothing, tentage, and leather goods has risen many times over their pre-war levels. The cessation or reduction in imports has brought about a rise in the output of glass, electrical bulbs and fans, canned food, biscuits and confectionery, pharmeuceticals and drugs and a number of other smaller industries. Heavy chemical firms started on the eve of the war have just begun production while some of the textile accessaries like starch are now being locally manu factured. A factory for the manufacture of almunia has also been brought into existence. Nevetheless, it would be true to say that this war has not brought about the establishment of any major industry as was done by the last war; and industrial capacity in general has not undergone any appreciable increase.

(3) As regards foreign trade, there have been changes in its direction largely

owing to the ban on trading with enemy countries and the operation of import and exchange controls, while the composition of our foreign trade has also undergone a significant alteration in the direction of an increase in the exports of manufactured goods and a substantial fall in the imports of manufactured goods together with a rise in the imports of raw materials; there has also been a fall in the imports of machinery and industrial equipment.

(4) Employment in the country has increased substantially since the outbreak of war. It is not possible to get detailed figures, but it is understood that the defence forces alone account for an increase of more than 2 millions in employment. There is also a big increase in Government and private industrial employment which is believed to amount to 1.3 millions. There is also a certain measure of increase in the employment of administrative personnel in Government offices, and an increase in employment in private trading establishments. There is also the part-time employment which war orders have

brought to many Indian villages. Excluding the increase in part-time employment, the increase in employment arising out of the war can be conservatively estimated to be more than 3.5 million persons.

(5) Turning specifically to the position of industrial labour, one finds considerable improvement as a result of the war. Wages have gone up, employment has increased and the number of skilled workers has recorded an appreciable rise partly on account of the increase in engineering establishments and partly on account of the scheme of technical training covering more than 40,000 persons instituted by Government in connection with their programme of munitions manufacture. But the end of the war with its demobilisation and closing down of Government production and demand will upset the situation and probably result in an era of unemployment and industrial disputes.

(6) India has already ceased to be a debtor country, as far as her public indebtedness in terms of sterling is concerned; and the sterling balances still left over,

after repatriating our sterling debt, is already in the region of Rs. 500 crores; and if the war lasts for another 2 or 3 years, they may well reach the figure of Rs. 1,000 crores. This will mean that, even allowing for British private investments in Indian industry, commerce and real estate, India will be a creditor country. The problem therefore will have to be faced about what we should do with our sterling balances and the manner in which they are utilised will have an obviously tremendous effect on the volume and composition of our imports and therefore affect significantly the industry and economy of the country. Our industrial and fiscal policy is also likely to be affected by our new position as creditor.

(7) The taxation and public expenditure of this country has already risen enormously; and are likely to rise further with the continuance of the war. If past experience is a guide, expenditure is not likely to diminish immediately after the war. After a while, however, retrenchment is bound to appear; but it is certain that the public expenditure of

of this country will stand at a permanently higher level than before the war; and a good part of the increase would be what is called unproductive expenditure.

(8) The railway equipment of this country as well as its industrial equipment have been used up a great deal during this war; and wear and tear have reached enormous dimensions. Repairs have been postponed, replacements avoided and extensions not made. This would create an immense demand for capital goods after the war.

(9) Prices have already gone up 172% over the pre-war level; and if the present method of financing the war effort continues and the war lasts for another two or three years, one does not know what heights our price level would reach. Assuming that in spite of this, public confidence in the currency would not cease and that India will not get into the currency debacle that befell the central European nations after the last war, the problem of how to get back from the high price level to a more normal level would still remain. Deflation is a terrible experience and it will confront the

country at the end of this war, particularly if there is a big rush for imports and a consequent adverse turn in the balance of trade.

It is clear from this brief review that the changes in our economy caused by the war are not all of the same character. Some are obviously temporary like the rise in prices, the increase in employment, the enforced reduction in imports and the enforced postponement of the demand for capital goods; and these are likely to be followed, in the absence of a deliberate policy in the opposite direction, by a swing-back in the economic organisation and consequent problems of readjustment. This will produce what are usually known as the problems of transition from a war-time to a peace-time economy. There are some other changes which are likely to be more permanent such as the conversion of India from a debtor to a creditor country, the increase in her public expenditure, and the expansion in the steel and in the light engineering industries; these are bound to influence the post-war trends in trade, public finance and economic development. Then again, superimposed on the post-war economic problems of India are her permanent economic problems, *viz.*, the problems of poverty, of industrialisation, of food supply, of unemployment and

under employment, in other words, the increasing desire of her people to utilise their economic resources for raising their standard of life. Above all, the post-war political status of India, the nature of its Government and its attitude to the part that India should play in international economic life and the ability to enforce that attitude, all these will have an overwhelming influence on the immediate post-war economic outlook in India.

The post-war economic problems that will confront the country are those of unemployment and deflation, the breaking of the boom that has been caused by war demands and war expenditure. At the same time, there will be an immense volume of post-war demand in the country for both consumption and capital goods which, if allowed to operate in an insulated economy, will release forces that will counter, at least to some extent, the slump forces emerging from the termination of war. There will also be the demand from the exhausted belligerent powers for Indian industrial goods and raw materials, which, if allowed to operate under proper control, can also help in countering the impending slump. Finally, there are the long-existing requirements of India in the field of both food supply and manufactured goods which

need to be satisfied and can be converted into an effective demand for increased production by an appropriate Government policy. Given a suitable economic policy, therefore, and a proper political background, the post-war economic outlook in India need not fill us with alarm. Neither deflation nor unemployment are inevitable in India at the end of the war ; and it is for Government to see that they are not made inevitable. On the contrary, it is possible to follow an economic policy that will increase production and employment, enhance real incomes and make the post-war economic period the beginning of an era of healthy and planned development of Indian economy. We turn in the next section to a discussion of the broad fundamentals that should underlie such an economic policy.

The immediate objective of post-war economic policy should be to avoid the unemployment and economic distress that usually follows the termination of war; its more permanent objective should be to devise such measures for meeting its immediate objective as will result in the long period development of Indian economy and the raising of Indian production to levels that will ensure its population a reasonably high standard of life.

The best way of indicating the essential features of such a policy would be to visualise the post-war economic situation in India in the absence of such a policy. Thus e.g. the termination of the war will be followed by a closing down of Government factories, cessation of Government demand on private industry, and demobilisation of the defence services and the extra personnel recruited in the Civil departments. The result will be unemployment, slump in prices and more unemployment. The immediate removal of all import and export controls will be followed by a big jump in imports of both goods and treasure, there is likely to be an adverse balance of trade and a fall in the exchange value of the rupee leading to sales of sterling, equivalent cancellations of rupee currency, and all the consequences of deflation. Unrestricted imports will lead to adverse effects on the industries established during the war period and there will be a further fall in employment. The fall in prices will lead to industrial disputes all over the country. Government revenues will fall and deficits will mount, with the result that retrenchment will be undertaken on a large scale and lead to a further fall in public incomes. The total volume of economic activity will diminish and the country will face

all the horrors of a post-war slump.

This terrifying picture is simply an illustration of what will happen to the country, if it did not have a clear and well thought—out post-war economic policy planned and ready right now, before the termination of the war. It is obviously not possible in this brief volume to discuss in any detail the constituents of such a policy; and apart from the question of space, the necessary data are also largely lacking. All that we can do therefore is to indicate the broad outlines of such a policy leaving to more well-informed persons to fill in the details of the picture.

Before proceeding to do this, however, it is important to draw attention to one important political condition of such a policy. If the post-war economic policy, with its probable controls and regulations of economic activity, is to succeed, it must be undertaken by a Government in whose freedom from subservience to British interests the people have faith, in whose capacity and public spirit they have confidence, and in whose identity of interest with themselves they have a firm belief. In other words, it is only a national government responsible to the people which can command the confidence and the authority

necessary to put through a comprehensive scheme of post-war economic policy.

The first essential of post-war economic policy is to prevent an abrupt transition from war time economy to peace time economy. The termination of war should not be immediately followed by demobilisation of defence personnel and closing down of Government armament factories. Both the demobilisation and the closing down of ordnance factories should be carried out by stages so that the number of persons for whom alternative employment will have to be found will not be too unmanageable at any one time. Similarly war time restrictions on imports for which substitutes have begun to be manufactured in the country should not be abruptly terminated as that will expose the new domestic industries to sudden and severe foreign competition and most probably lead to their disappearance. It is also necessary not to permit an immediate relaxation in the imports of consumption goods as otherwise there will be an abnormal increase in such imports due to the emergence of war—suppressed demand, and this in turn may lead to an adverse balance of trade and cause sales of sterling with consequent deflationary effects. For the same reason control

over foreign exchange transactions should not be immediately relaxed. Otherwise there might be a flight of Indian capital into foreign currencies which will also lead to sales of sterling and consequent deflationary effects. For all these reasons, therefore, it is necessary that war time controls and restrictions should not be abruptly terminated, but that they should be gradually relaxed so that the transition from war economy to peace economy is by such stages as will permit effective handling by Government of the problems arising therefrom.

Secondly the securing of employment for the demobilised personnel and the industrial workers released from war industries is obviously an immediate objective of post-war economic policy. But this objective should not be secured by the provision of unproductive and temporary employment which will only increase the burden on public finance without providing a long term solution. In other words, long period objectives should be borne in mind when providing employment for those who become unemployed on account of the end of the war; the employment provided must be such that on the one hand it contains within itself seeds of permanent employment and on the other does not

require the imposition of burdens upon the public revenues over a long period. Government's employment schemes should be such that those who get employment will remain permanently employed and their employment will not depend upon the state of the public revenues. To secure this objective, the post-war need for employment should broadly be treated in two categories. (1) Public works which will be largely financed by Government (2) encouragement of industrial and economic activity in the country which will lead to greater output and increasing employment. The public works scheme also should be of such a type as not merely to serve temporary objectives but will result in works of permanent utility which will increase the productive capacity of the nation and facilitate larger production and provide greater employment. Illustrations of the kind of public works that will satisfy this criteria would be the construction of roads, bridges, buildings, wells, tanks, minor irrigation works, hydro-electric works etc.

The more valuable part of the scheme is the facilitating of re-employment of the demobilised personnel by private industry. This can be done in the following ways :—

(1) by giving protection and such other

assistance as may be necessary to enable the survival of the new industries brought into existence during the war. It is not of course contended that any and every industries arising during the war period should be subsidised to exist irrespective of its long period economic position. But it is necessary that a thorough examination should be made of all these new industries and it will then probably be found that a much larger number of them deserve to survive than may appear at first sight. The correct thing to do would be for Government immediately to undertake a survey of all new industries that have come into existence during the war period and after determining the margin between their costs and the probable costs of their foreign competitors they should undertake a detailed investigation into the short period and the long period possibilities of diminishing this margin and they should help not only by protective duties but also by such methods as purchase of output, bounties, research facilities etc. If this is done, a number of industries which have come

into existence on account of the war time restrictions on imports will now take permanent root and help to provide additional employment.

(2) By helping to establish industries in the country which will produce substitutes for the imports for which there will be a big post war demand. This again means a survey of the directions in which the increased demand is likely to manifest itself and a detailed investigation of the possibilities of establishing in the country industries which will manufacture these commodities. Wherever there is a reasonable possibility and the difference in cost is not likely to be much over a long period, Government should help to establish such industries both by the imposition of protective duties and by other well known methods of state assistance. Illustrations of such industries would be those dealing with electrical goods, drugs and chemicals, confectionary and canned provisions etc. In the intervening period between the establishment of these industries and their eventually being able to produce the required output, Government should permit imports under control and

subject to duties the proceeds of which can be utilised for helping the new industries.

(3) By helping to establish in the country capital goods industries, particularly industries dealing with manufacture of automobiles, locomotives, ships, machinery, and machinery tools and heavy chemicals. As we have already seen, the end of the war will be followed by a large demand both from Government and private industries for the type of goods mentioned above; Government, instead of being in a hurry to get all these demands met by imports, ought to exercise control and permit in the beginning the satisfying of only the most urgent of these requirements from foreign sources. In the meanwhile they should take steps to utilise sterling balances accumulated in England to purchase the necessary capital goods for the establishment of these industries and thus help in removing the basic deficiency in India's industrial structure which has prevented her from achieving to the full her industrial potentialities.

These measures will help to produce perma-

nent sources of employment within the country and in turn they will help to produce more employment. At the same time there will also be an increase in the national output of goods and services and consequently a rise in the standard of life of the people.

Thirdly, Government ought to plan its currency policy with respect to domestic requirements. Thus for example there should be no agreement on their part to maintain intact the exchange value of the rupee at 1s. 6d. sterling if this is going to mean, as it is likely, embarking upon a deflationary policy. There is no reason why the pre-war level of prices in this country should be regarded as a normal level of prices to which the country must be forced to return. On the contrary there is ample reason for believing that the pre-war level of prices, particularly of agricultural goods, was below the economic level. It is necessary, therefore, for the currency authority to think in terms of preserving for the cultivator a part of the rise which has taken place during the war in the prices of his commodities. It may also be pointed out in this connection that the Reserve Bank of India has ample sterling reserves and that as long as the sterling including gold backing

does not fall below 40% it is not necessary that sales of sterling shold be followed by an automatic cancellation of equivalent amounts of rupee currency. The Reserve Bank is thus in a particularly strong position to resist deflation even if there is a rush for foreign currency at the end of the war. What is necessary is that an enquiry should made into the question of the economic price level in India, a price level that will assure economic justice not only to the middle classes and the industrial worker, but also to the peasant. On the results of such an enquiry the currency authority should determine what is going to be its object as far as the Indian price level is concerned and the securing of this objective ought to be made a part of our post war economic policy. This would mean that the Government of India should not hastily commit themselves to any international plan restricting their freedom of currency control but should wait the results of such an investigation and the formulation of their own currency objective before undertaking international commitments.

Fourthly Government ought not to commit themselves to any international agreement regarding control of tariff policy and freedom of international trade without examining the reper-

cussions of such an undertaking on Indian interests, specially on the execution of the plans formulated above as a part of our post war economic policy. It is well known that agreements to stabilise tariffs at their present levels and free international trade from all controls will only mean a stabilisation of the *status quo* regarding production and incomes in the different countries of the world; so long as the different countries retain their independent existence and spend their revenues only on their own people, it is inevitable that backward economic regions will insist on their being permitted to realise their potentialities even if this involves a control over trade and tariff in the national interest. Freedom of tariff policy is particularly necessary in the case of India if she is to develop as an industrial nation. It should be an essential feature of our post war economic policy that the country retains its freedom to regulate its trade and tariff policy in the Indian interest, at least till such time as the country may take to reach the full stature of its industrial nationhood.

Fifthly, the rehabilitation of Indian agriculture should form a part of post-war economic policy, particularly the question of improvement in both the quantity and quality

of the food available to the Indian people. Attempts should be made to colonise demobilised soldiers on cultivable waste lands and encourage them to go in for co-operative farming by giving them capital equipment and concessions of revenue. A vigorous drive should be undertaken to increase yield by State supply of seed and manure. Dietetic surveys already conducted in different parts of the country have shown the grave and differing deficiencies in India's food supply in different regions; and recent difficulties regarding food supply have reinforced this lesson. Regional planning is therefore necessary with regard to agricultural crops and the post-war period would be an appropriate time to begin the work in this direction.

Sixthly, Government ought to be ready to face the fact that labour will be one of the most important problems that will have to be dealt with in the post-war period. The post-war economic policy should therefore include plans for labour exchange and labour transfers which will facilitate the problem of re-employment. In view of the greater likelihood of industrial disputes after the war, measures should also be ready for a speedy and compulsory settlement of industrial disputes. Provision for social security measures for industrial labour

should also be on the anvil.

Seventhly, Government should pay due attention to the economic needs of the different regions in India in their schemes for re-employment of demobilised labour and for industrial expansion. Provincial differences and jealousies are already becoming a potent factor in Indian politics; and if India's unity is to be preserved, care must be taken to see that all provinces share in the benefits of industrial expansion and that there are no capitalist regions which can dominate the rest of India. Decentralisation should be a cardinal principle of planned industrial policy and should be accompanied by special encouragement of small scale and cottage industries. If this is to be achieved, it is necessary that an investigation should be immediately undertaken not only into the condition of new industries emerging as a result of the war and into the possibilities of further industrialisation, but also into the question of the location of industries and the size of industrial units. In fact, such an industrial enquiry is long overdue and must be immediately undertaken by Government for purposes of formulating their post-war economic policy.

Then again, careful attention should be

paid to the financial aspects of post-war economic policy. The execution of even some of the suggestions made above will involve considerable outlay on the part of Government. The amounts involved will be so large-they will probably run into hundreds of crores of rupees-that a vast loan programme will have to be undertaken; and this will have to be put through by stages. It is necessary therefore that a preliminary survey should be immediately undertaken of the financial implications of a successful post-war economic policy both in terms of amounts involved and stages in which required; and the possibility of linking up this programme with the utilisation of sterling balances should be carefully investigated.

It is also necessary for Government to begin thinking of a long-period plan for the economic development of India. We have already pointed out that one of the essential features of post-war economic policy should be the linking up of the plans for dealing with the immediate problems of post-war economy with the long-period problems of Indian economic development. This cannot be done unless the long range plan for India's economic development is decided on now, at

least in its main essentials. The objective of of such long range planning is fairly clear and not subject to controversy; everyone wants a substantial rise in the standard of life of the Indian people and this cannot be done without a vast increase in the country's output of goods and services. How this objective is to be attained is a more difficult question and needs a good deal of investigation and careful planning. In view of the need for linking up of this plan with the handling of the immediate problems of post-war economy it is essential that Government should undertake without delay an investigation into the outlines of a long range economic programme for India. In this connection it is a pity that the activities of the National Planning Committee appointed by the Congress were permitted to come to an end and no advantage taken by Government of their long and careful deliberations. Even the various Reconstruction Committees which Government have themselves appointed to consider different aspects of post-war economic policy have largely been moribund and the Consultative Committee of Economists constituted by Government to advise them on post-war problems has only met twice so far, the last meeting

having been held in March 1942. Government have now decided to pay more attention to the question of post-war reconstruction and have constituted a Sub-Committee of the Executive Council to deal with the same, with the Viceroy as President and the Hon'ble Sir J. P. Srivastava as Vice-Chairman. But no separate department of post-war reconstruction has been constituted; and it appears that each department of the Government will deal with that aspect of post-war economy with which it is particularly concerned. This arrangement is unsatisfactory and cannot lead to a clear, and well-planned formulation of post-war economic policy; and it is also likely to lead to much delay. If the problem of post-war economic policy is to be solved speedily and adequately there must be an independent department of post-war reconstruction to deal with it, even if this means a certain measure of what may be regarded as restriction of their autonomy by the different departments; the subject is also important enough to justify the creation of a separate portfolio to be held by a member of the Executive Council. There need be no fear that the Member in Charge of Post-war Reconstruction and his department will have the entire say, for after all, he and his department

will have to function within the Government of India and it is the Executive Council as a whole which will be responsible for the ultimate formulation of policy and the taking of decisions thereon. The question of post-war economic policy has been already neglected too long; and it is unlikely to receive the attention it deserves unless it is in independent charge of a member of the Executive Council with a full-fledged department to assist him. The people have already suffered during the war as a result of the lack of foresight and planning on the part of Government during the pre-war period; let them not suffer again after the war, because of a repetition of this attitude. It is agreed on all hands that winning the peace is as important as winning the war; and this cannot be done without timely attention being paid to the questions of post-war economic policy before the war ends and the problems emerge for immediate handling. It is hoped therefore that a more vigorous and lively attention will be paid to this question by Government without waiting for the termination of war.

One thing more must be emphasised with regard to this question of post-war economic policy. If it is to have any chance of securing public good will and co-operation—and without

such good will and co-operation it is unlikely to succeed—, people must be convinced that it is planned in the Indian interest. There has been a good deal of agitation in England over the question of sterling balances which rouses natural suspicions in the Indian mind. It has been contended that England has been saddled with an unduly large portion of the military burden in defence of India with the result that she has become India's debtor; and vague hints are thrown that India will have to do something to rectify this wrong. Actually it is well known that all the burden of the military expenditure incurred by the Indian armies within the geographical frontiers of India are debited to Indian revenues ; and that the debiting to British revenues of the expenditure incurred in the Middle East, the Far East and the Near East is in accordance with an agreement freely arrived at between the British and Indian Governments on the outbreak of war. It is also known that considerable concessions have been made in the form of charging lower prices for transport and other services supplied to the British Government. Out analysis should have also made it clear that the sterling balances acquired by India represent so much net reduction in consumption and standard of living that the Indian people

have undergone in order that the British and Allied Governments may get their supplies at the expense of the supplies available for civilian consumption in India. It is also important to remember that a part of the reason for the magnitude of our sterling balances is the result of the high level of prices in India directly connected with Government's war-time economic policy. Finally, it is not irrelevant to note that a good part of the internal industrial profits accruing out of the war have gone to British firms in India and that a British-Government controlled company—The United Kingdom Commercial Corporation—is having a lion's share of the export trade in private merchandise to the Near East and the Middle East. Under these circumstances, it does not sound quite fair to the Indian listner that there should be talk of these sterling balances as if they were some kind of an unfair advantage which India obtained as a result of the war. It is this talk which has made the Indian suspicious; and such suspicion is not conducive to the successful handling of the problems of post-war economy in India. It is necessary therefore for the Indian Government to insist that our sterling balances are our own affair and that the British Government shall not lay down conditions as to how they shall be utilised, though it is always open to us to use

them for the purchase of capital goods from the British market if other conditions are suitable to such purchase. Unless such a declaration is made, and unless the people are assured that bodies like the U.K.C.C. will have no place in Indian economy after the war, there is not much chance of ensuring public co-operation with the post-war economic policy.

Above all it is necessary that the formulation of our post-war economic policy should be made by a Government commanding the confidence of the Indian people ; and that India's voice at post-war Conferences should be heard through her own authentic representatives. A National Government is as necessary for the successful handling of post-war problems as it is for handling the problems of war economy ; in fact, even more so. The absence of a National Government during the war has, as we have already seen, created vastly difficult economic problems ; it has led to insufficient emphasis being laid upon production and extra stress on diversion of supplies from civilian to military purposes ; it has thus created the problem of scarcity of civilian supplies and at the same time failed to meet the difficulties arising therefrom by not resorting to price control and rationing ; it has also led to the use of the currency mechanism

on a large scale for financing the war effort and thereby led to inflation. Scarcity and inflation in India are thus directly related to this absence of a National Government. If there were to be also no National Government handling post-war problems, the difficulties of post-war economy in India are likely to be even greater. Too much stress cannot be laid therefore from the strictly economic standpoint on the need for solving the political deadlock and establishing in India a Government that will be regarded as a people's Government. Only such a Government can see the Indian economy successfully through the war and enable the country to pass successfully through the difficult post-war period towards an era that will assure the long-range economic development of the country and a rising standard of life for the masses of her people. It is not possible to divorce economics from politics; and politics which involve immense Governmental regulation, control, and expansion of private economic activity must have the appropriate political background for success; and that background for India is the formation of a National Government.

APPENDIX 1.

RECENT TRENDS IN INDIA'S WAR ECONOMY.

The current financial year has seen a further development of the tendencies explained at such length in the preceding pages.[1] Prices have continued to rise, sterling balances are continuing to accumulate and the food problem is daily growing more intense in its urgency. The position as compared to that prevalent in March is summed up below :

	March 1943.	July 1943.	Difference.
Notes in circulation. (in crores of Rupees), ..	635.7	735.6	+ 99.9
Sterling Securities in the Issue Department. (in crores of Rs.) ..	401.5	574.0	+ 172.5
Demand Deposits of Scheduled Banks. (in crores of Rs.) ..	372.3	428.1	+ 55.8
Total of Cheque Clearings. (in crores of Rs.)	(April-July 42) 795.0	(April-July 43) 1,380.3	+ 585.3
Calcutta Index No.	272	332	+ 60
Bombay Index No. ∝	256	265	+ 9
Cost of living index, Bombay.	208	227	+ 19

1. The writer has taken advantage of the interval between sending the manuscript to the press and receipt of final proofs to bring this appendix uptodate.

∝ Figures given in column 3 for Bombay refer only to May as later figures are not available.

But this year has seen an unusual display of energy on the part of the Government in their war-time economic policy. They have at last admitted the existence of an inflationary situation in India by the appointment of an officer on special duty to devise counter-in flationary measures; and several steps have already been taken by them in this war against inflation. Government's counter-inflationary compaign has taken three forms:

(1) War against speculators.

(2) Draining off purchasing power from the market for civilian goods.

(3) Control of cloth prices.

The war against speculators was started by the Finance Member in a sensational speech that he made in the budget session of the Assembly when he warned the Bombay, market against the rise in cotton prices that was taking place and threatened speculators with fearful consequences. This was followed by the issue of several ordinances banning forward dealings in a number of commodities the most important of which was cotton, other oil seeds, bullion and cotton yarn and cloth. Bull speculators had their enthusiasm definitely damped by these moves, and the

Finance Member declared that the bear speculator was his friend and he was ready to hug the bear to his bosom. While there is no doubt that this war against speculators had the effect of unsettling commodity markets and inducing in them a bearish tendency, it must not be forgotten that forward trading has a definite place in the machinery for formation of prices, particularly in smoothening fluctuations by bringing anticipated future movements in demand and supply to bear on present prices and thereby inducing an adjustment of future supply to future demand. Possibly the Finance Member's idea was to bring down present prices of non-food crops and thus encourage diversion of cultivation from non-food to food crops. But this was not the correct way to do it, particularly if the demand for these commodities proved greater than their supply in the future and thus led to a rise in their spot prices. The better thing would have been, as already suggested by us, to have subsidised the extension of the area under food cultivation by means of revenue and other concessions and actual gifts of money, if necessary. In any case this war against speculators is what may be termed a war of nerves. It will have some preliminary deflationary effect, but this

effect will not be sustained unless the fundamental factors responsible for the rise in Indian prices are tackled; and these factors are, as we have pointed out repeatedly, scarcity of civilian goods and weekly additions to the country's purchasing power. Unless therefore the inflationary problem is tackled on both the production and the monetary front, it is not likely to be solved. Speculative rises in prices on account of forward transactions are only a symptom, an advance warning as it were, of the existence of real factors making for a rise in prices. And tackling the symptoms will not cure the disease, unless it is intended to give the authority breathing time to execute a co-ordinated plan to strike at the real causes of the malady. But so far, one does not see much evidence of this co-ordinated plan as far as the major remedies are concerned.

The second set of counter-inflationary measures undertaken by Government were contained in an ordinance issued on the 17th May and were designed to freeze a certain amount of purchasing power and thus prevent it from reacting on prices. This ordinance introduced a system of summary assessment of the Excess Profits Tax which was expected to remove from the market the outstanding col-

lections, which Sir Cowasji Jehangir had estimated in the Assembly at Rs. 75 crores. Other measures included in the ordinance were :—

(1) The option given to the Excess Profit Tax assessee to deposit one fifths of his excess profit with Government on condition that Government adds half of it thereto and returns it to him with a 2% interest within 2 years from the date of deposit or one year from the conclusion of peace (which ever is the longer period) was now made compulsory.

(2) More rigid limits were imposed on the payment of bonuses and commissions by companies and employers.

(3) Power is given to the authorities to prescribe by rule what stocks shall be deemed reasonable for income tax purposes, so that it will discourage hoarding on the part of firms and companies.

While these provisions do constitute a definite improvement on the previous position and will have some effect on prices, it must be pointed out that they mainly affect pur-

chasing power belonging to the richer classes who would even otherwise have in many cases deposited it with banks and thus not permitted it to play an active role in raising prices. The really active purchasing power is that accruing to peasants and industrial workers as a result of war finance; and this is not likely to be affected by the measures outlined in this counter-inflationary ordinance.

Similarly the order prohibiting the issuance of new capital without the previous sanction of the Government of India contained in the new Defence of India Rule No. 94-A is not likely to be very effective as far as rendering immobile active purchasing power is concerned. It is true that by closing other outlets for the investor, it might lead to more subscriptions for Government's Defence Loans; but this need not necessarily follow, especially if public reluctance to invest in Defence Bonds were due to non-economic reasons. Secondly, under the present circumstances of import controls, domestic controls, and railway priorities, even newly formed private companies cannot really start business and indulge in much spending and are more likely to keep their capital in banks or invest it in Government Securities for the duration of

the war; if this is true, banning or limiting the creation of new companies is not likely to lead to any net additions to the volume of immobilised purchasing power. Further, the class of persons who are likely to invest in shares and who will now have an investment avenue closed to them are not likely to belong to the category of workers and peasants whose additional purchasing power it is which is exercising such an active influence on prices. Finally, such control of new companies at a time when the public is industry—minded and has the means to indulge its taste is likely to slacken the mobilisation of industrial capital and thus retard the pace of industrial development. On the whole, therefore, I am not convinced that this order controlling the issue of new capital is in the best interests of the country *.

* It is true that the professed object of this rule is "to prevent growth of mushroom companies which stand little chance of survival in the post-war period," but there is also no doubt that it has been introduced on the British analogy where it formed a part of the anti-inflationary measures undertaken in that country. As a safeguard for the undiscriminating investor, there is something to be said for this rule provided it is not used to retard industrial development. This would have been more likely—in any case there would have been less public distrust—if the administration of this rule had been entrusted to a body on which industrial and commercial interests were represented and not to an executive officer unaided by any non-official committee.

The third set of counter-inflationary measures undertaken by Government is with respect to cloth. Government have decided that the position regarding cloth is so serious "that the only effective remedy lies in the establishment of control designed to regulate prices of cloth and yarn and to increase their production." They have accordingly set up a control organisation under a Textile Commissioner aided by a non-official committee drawn mostly from the textile interests; and among the problems to be considered by the Control, Mr. Hydari, Secretary to the Industries and Civil Supplies Department, mentioned the extension of multiple-shift working to the fullest possible extent, rationalisation of specifications, and fixation of maximum selling prices. In order to make the price control effective Mr. Hydari declared that there will be two sets of prices, viz maximum prices ex-mills and maximum prices for retail sales, the latter being stamped upon the cloth and that steps will be taken to limit the period beyond whieh neither the manufacturer nor the merchant can keep given stocks, the date of manufacture being stamped on each piece of cloth. As an immediate measure for bringing down prices he also declared that steps

will be taken to bring on the market immediately all existing stocks, by whomsoever it may be held. Steps were also to be taken to fix the prices of cotton and other mill stores entering into cloth production so that mill-owners may not unduly suffer by the introduction of control. The millowners also expressed their readiness to assist in measures designed to bring down the price of cloth; and after some discussion, complete agreement was arrived at between Government and the industry on the subject of control.

The Government of India thereupon issued the Cotton Cloth and Yarn (control) Order on the 16th June embodying the main conclusions arrived at in the conferences between Mr. Hydari and the millowners. The order provided for the compulsory disposal, by the wholesaler and manufacturer before the 31st August, and by the retailers before the 31st October, of all cloth and yarn manufactured before 1st August; cloth or yarn manufactured after that date had to disposed of by the manufacturer within 45 days from the date of packing, by the wholesaler within 90 days of this date,, and by the retailer within 180 days of this date. The immediate effect of this order was a rush to dishoard stocks on the

part of those concerned and there ensued a substantial fall in cloth prices. And now, maximum prices have been fixed by Government for the leading varieties of cloth.

There is no doubt the Government have been fairly successful in their policy as far as bringing down the price of cloth is concerned. In fact, it is the first instance of control in the matter of civilian supplies where Government has achieved its objective and the Department of Industry and Civil Supplies deserves congratulation on its success in the very first problem it has handled. But it is not certain how long this success will last. For the fundamental problem regarding cloth prices is not so much hoarding as short supply accompanied by an expanding monetary demand. This fundamental condition has not been substantially changed as a result of the Cloth Control Order, and as soon as the effect of dishoarding of stocks wears off, it will reassert itself and may result in the emergence of black markets for cloth. To be effective, price control requires equillibrium of demand and supply at the controlled price ; and that can be brought about only by a simultaneous increase in supply and a rationing of demand. Otherwise, we may find cloth control ending up the same

way as wheat control, particularly because there is today a large demand for cloth from rural areas for purposes not of consumption but of investment. It is only when the weekly additions to the volume of purchasing power in the country either comes to an end or gets diminished and increased purchasing power gets immobilised that the problem of price control will be successfully tackled from the demand end ; and from the supply end, we need large increases in the production of civilian goods.

The record of Government with reference to the other question confronting the country *viz.* the food problem is not so gratifying. General Wood's confident expectations about the ability of his department to tackle the food problem and in particular to bring down the price of rice in Bengal have not been fulfilled. In any case, shortly after he made his speech, the food situation in Bengal grew worse and in response to the urgent request of Bengal, free trade in food grains was restored in the eastern region ; and there was talk of its being extended all over the country. This brought out vigorous protests from Bihar, Orissa, Madras and other provinces which were afraid that it would result in the disapparence from their jurisdiction of even the

little stocks of food grains they possessed. This was followed by the Government of India convening an All India Food Conference at Delhi in the first week of July; and as a result of its deliberations, Government announced their new food policy. This included the retention of provincial controls over the movement of food grains within their areas, promise of a merciless attack on hoarders, introduction of rationing in urban areas and an assurance by the Central Government to try their best to bring down the general price level and increase the supply of consumer's goods. It was also decided to set up a committee to discuss the problems of long-range planning regarding food supply and present its report to another conference to be convened in September.

So, far, however, Government's policy with regard to the food problem has not proved successful.* Without going into further details, it seems clear that among the factors responsible for the continued existence of this problem are the following:

The situation with regard to food supply in Bengal is without precedent in recent periods of Indian History; and official communiques issued by the Director of Information, Bengal, contain harrowing accounts of daily deaths in Calcutta due to starvation.

(1) A real shortage in the supply of food grains.

(2) Lack of adequate transport facilities for shifting food grains from the surplus to the deficit provinces.*

(3) Intransigience of provincial administrations and lack of Central control in this matter.

It is also clear that hoarding has not been adequately tackled. It must be remembered that in order to tackle hoarding successfully, Government must not only penalise hoarders but must also make hoarding unattractive by arresting the rising trend in the price level, and this cannot be done without stopping or diminishing the weekly additions to purchasing power in the country; alternatively, the increased purchasing

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This is clear from the statement of Sir Chothu Ram of the Punjab Ministry that while Punjab had bought 218,654 tons of wheat at the instance of the Government of India for transmission to Bengal, transport facilities made available by the Central Government were only for 64,000 tons. *The Hindustan Times* of 23rd August. Further confirmation is also available from a communique issued by the Government of United Provinces that lack of transport prevented them from sending to Bengal 10,000 tons of foodgrains which they were wanting to send. *The Leader* of 2nd September.

power must be immobilised; neither of these things have been accompolished successfully so far; while, on the demand side, rationing has been introduced as yet only in a few cities, and, on the supply side, little addition has been made to the supply of the consumer's goods which are in shortage. Under the circumstances, hoarding is natural on the part of both the trader and the farmer; and it can't be rooted out merely by enacting stringent penalties. The disease has to be treated at its source.

To sum up, the economic situation today is not much better than it was before 4 months. The fundamental difficulties still remain viz. inadequate mobilisation of productive resources, shortages in supplies of consumption goods, and use of currency mechanism for financing the British Government's war expenditure in India with all that it implies on the willingness to work and to save on the part of the people of the country. The problem of scarcity and inflation still remains and continues to be aggravated by the absence of a people's Government at the centre and in most of the provinces. The only change is that the Government of India appears to be much more conscious today than they have been before of the nature and urgency of the problems of Indian War Economy, and in particular of the

importance of civilian supplies or supplies of consumer's goods. But they have not yet realised the connection between the present economic situation in the country and their political policy of disassociation with the major political parties in the country. Unless and until they perceive the political *sine-qua-non* of a successful war economy and reconstitute themselves on a popular basis, there seems little hope of their successfully tackling the problems of India's war economy.

APPENDIX 2.

POST-WAR CURRENCY PLANS.

In view of the discussion going on at present on post-war currency plans, I have thought it worthwhile to add this brief note on India's post-war currency requirements.

As a result of the repatriation of her sterling debt, India is likely to have a favourable balance of payments after the war. She can liquidate this favourable balance either by lending abroad or by importing goods. The former alternative is not likely to be acceptable in view of the poverty of the country and the immensity of her own capital programme in the post-war period. As regards the latter alternative, India will not be prepared to accept payment in consumer's goods that will compete with domestic industries and cause dislocation in her domestic economy. There are however certain kinds of capital goods that India will be willing to buy, but these should consist of, not obsolete machinery and exorbitant prices, but equipment of the quality and efficiency required by the country and at prices which are reasonably competitive. Otherwise it will be better

for India to reduce her exports and thus liquidate her favourable balance rather than agree to imports which are either useless for her economy or positively harmful to her economic development. In no case can a backward economy like India, with the tremendous leeway it has still to make in industrial development, agree to external restrictions on the country's tariff autonomy.

Another requirement of India is the freedom to have a flexible exchange. Her long currency history of domestic instability and periodic slumps in agricultural prices has created a strong prejudice against the doctrine of stable exchanges in the country. Moreover the existing currency link with sterling is looked upon with disfavour nor is there any willingness to accept the present rate of exchange. Under the circumstances, it is wise to determine our own currency policy first in the light of domestic requirements, before adhering to any international currency plan restrictive of the country's currency autonomy.

Finally, it is not possible for India to agree to any long period freezing of her sterling balances. A part of these balances have been acquired in return for the country's normal favourable balance of trade and is therefore not abnormal; morever, as long as foreign in-

dustrial and commercial investments in India remain, it is legitimate to use our sterling holdings to re-purchase them; and to that extent the transfer problem is obviated. It is necessary therefore that there should be a clear-cut definition of abnormal balances and adequate provision made for the cashing of these balances within a reasonably short period.

To sum up, India's post-war economic requirements involve the freedom to have a flexible exchange, use of tariff walls to accelerate her industrial development, and speedy and effective utilisation of her sterling balances. On the face of it, these requirements are difficult to reconcile with the provisions of any of the post-war currency plans now under discussion. How, and in what manner, these plans should be modified in the Indian interests is a matter requirring more detailed discussion than is possible in this volume; but the fact remains that they will have to undergo considerable modification before becoming acceptable to Indian public opinion.